# PUBLIC HEARING

STATE OF CALIFORNIA

DEPARTMENT OF FOOD AND AGRICULTURE

DAIRY MARKETING BRANCH

DEPARTMENT OF FOOD AND AGRICULTURE

1220 N STREET

AUDITORIUM

SACRAMENTO, CALIFORNIA

THURSDAY, JULY 6, 2006

9:00 A.M.

JAMES F. PETERS, CSR, RPR
CERTIFIED SHORTHAND REPORTER
LICENSE NUMBER 10063

PETERS SHORTHAND REPORTING CORPORATION (916) 362-2345

APPEARANCES

HEARING OFFICER

Mr. James P. Aynes, Staff Counsel

PANEL MEMBERS

Ms. Hayley Boriss, Associate Agricultural Economist

Ms. Candace Gates, Research Manager II

Mr. Tom Gossard, Agriculture Economist

Mr. John Lee, Chief, Milk Pooling Branch

Mr. Don Shippelhoute, Milk Pooling Research Manager

STAFF

Mr. Steven Donaldson, Research Analyst II

ALSO PRESENT

Mr. James E. Dolan, Driftwood Dairy

Dr. James W. Gruebele, Land O'Lakes

Ms. Sharon Hale, Crystal Cream and Butter Company

Mr. Gary Korsmeier, California Dairies, Inc.

Mr. Steve James, Swiss Dairy, Dean Foods Company

Mr. Tiffany LaMendola, Western United Dairymen

Mr. Hank Perkins, Security Milk Producers Association

Dr. William Schiek, Dairy Institute of California

Mr. Gary Stueve, Dairy Farmers of America, Western Area Council

Mr. William C. Van Dam, Milk Producers Council

INDEX

PROCEEDINGS

HEARING OFFICER AYNES: Good morning. This hearing will now come to order.

The California Department of food and Agriculture has called this public hearing at the Department's auditorium, 1220 N Street, Sacramento, California, on this day, Thursday, July 6th, 2006, beginning at 9 a.m.

My name is Jim Aynes. I'm an attorney for the California Department of Food and Agriculture. I've been designated as the hearing officer for today's proceeding.

Jonathan Yates will be assisting me with exhibits.

On May 2nd, 2006, the Department received a petition from California Dairies, Incorporated, requesting a public hearing to consider amendments to the Transportation Allowance System in the pooling plan for market milk and transportation credits of the stabilization and marketing plans for market milk for northern and southern California marketing areas.

This hearing will consider the petitioner's proposal both to amend the pool plan in effect on July 6th, 2006; to amend transportation allowances for milk moving into the Bay Area receiving area, the southern California receiving area, and the San Diego receiving area; and to amend stabilization plants in effect on July

6th, 2006; to amend transportation credits for milk moving into southern California Class 1 plants.

The Department has received four alternative proposals in response to the California Dairies, Incorporated, petition. The Department has received these proposals from: Driftwood Dairy, Western United Dairymen, Security Milk Producers, and Dairy Farmers of America.

During a pre-hearing workshop conducted on June 13th, 2006, the Department provided an analysis of alternative concepts and proposals. A copy of the analysis will be entered into the record of this hearing as exhibits.

Accordingly, the purpose of this hearing is to consider the amendments as proposed by the California Dairies, Incorporated, petition; the alternative proposals, those offered by the organizations already mentioned.

Testimony and evidence pertinent to the call of the hearing will now be received. Anyone wishing to testify must sign the hearing witness roster located at the sign-in table. Oral testimony will be received under oath or affirmation. Staff available at the back of the room to provide assistance are Karen Dapper and Mary Riley.

As a courtesy to the Panel, Department staff and the public, please speak directly to the issues presented by the petitions and avoid personalizing any disagreements. Such conduct does not assist the Panel in its attempt to effectively address sophisticated economic and regulatory issues presented by the petitions.

For the record, testimony given at this hearing does not necessarily reflect the position of the Department regarding the proposed amendments.

Please note that only those individuals who have testified under oath during the conduct of the hearing may request a post-hearing briefing period to amplify, explain, or withdraw their testimony. Only those individuals who have successfully requested a post-hearing briefing period may file a post-hearing brief with the Department.

The Hearing Panel has been selected by the Department to hear testimony, receive evidence, question witnesses, and make recommendations to the Secretary. Please note that the questioning of witnesses by anyone other than members of the panel is not permitted.

The Panel is composed of members of the Department's Dairy Marketing Branch and include Thomas Gossard, Agriculture Economist; Don Shippelhoute, Agriculture Economist; Candace Gates, Research Manager; John Lee, Branch Chief, Milk Pooling; Hayley Boriss, Associate Agriculture Economist.

I'm not a member of the Panel and I will not be taking part in any discussions relative to the hearing.

The hearing recorder is Jim Peters of the firm of Peters Shorthand Reporting located in Sacramento.

A transcript of today's hearing will be available for review at the Dairy Marketing Branch headquarters located in Sacramento at 560 J Street, Suite 150. Anyone desiring copies of the transcript of today's hearing must purchase them directly from Peters Shorthand in Sacramento.

At this time, Steve Donaldson, Research Analyst with Milk Pooling Branch, will introduce the Department's exhibits.

Would you state your name, spell your last name for the record.

RESEARCH ANALYST II DONALDSON: It's Steven, with a V, Donaldson D-o-n-a-l-d-s-o-n. I'm a research analyst with the Milk Pooling Branch at Department of Food and Agriculture.

HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?

RESEARCH ANALYST II DONALDSON: I do.

May I proceed with my testimony?

HEARING OFFICER AYNES: Yes.

RESEARCH ANALYST II DONALDSON: Mr. Hearing Officer, my name is Steven Donaldson, as I mentioned before. I'm with the Milk Pooling Branch, Department of Food and Ag. My purpose here this morning is to introduce the Department's composite hearing exhibits numbered 1 through 7. Relative to these exhibits, previous issues of Exhibits 8 through 43 are also hereby entered by reference.

The exhibits being entered today have been available for review at the offices of the Dairy Marketing Branch since the close of business on June 28th, 2006. An abridged copy of the exhibits is available for inspection at the back of the room.

And I ask at this time that the composite exhibits be received.

HEARING OFFICER AYNES: The exhibits, 1 through 43, will be received at this time.

(Thereupon the above referenced document was marked by the Hearing Officer as Exhibits 1-43.)

HEARING OFFICER AYNES: Are there panel questions in regard to the exhibits?

Does anyone in the audience have questions regarding the content of the Department's exhibits?

Please recognize that questions are limited to the purpose of clarification. Cross-examination of Department staff is not permitted.

Please identify yourself and your organization for the record before asking any questions.

Seeing none.

California Dairies, Incorporated, now has 60 minutes to make its presentation.

Oh, I'm sorry.

RESEARCH ANALYST II DONALDSON: I'm sorry, Mr. Hearing Officer.

I do request the option to file a post-hearing brief.

And that does conclude my testimony. Thank you.

HEARING OFFICER AYNES: Thank you.

All right. All right. California Dairies, Incorporated, now has 60 minutes to make its presentation to support its petition.

Will you state your name and spell your last name for the record please.

Would you state your name, spell your last name for the record please.

MR. KORSMEIER: Yes, Mr. Hearing Officer, members of the Panel. My name is Gary Korsmeier K-o-r-s-m-e-i-e-r. I'm President --

HEARING OFFICER AYNES: Do you swear to tell the truth and nothing but the truth.

MR. KORSMEIER: I do.

Sorry.

MR. KORSMEIER: I'm President and Chief Executive Officer of California Dairies, a milk marketing cooperative representing approximately 700 members, marketing over 40 percent of the milk production in California.

Our recommended changes today to transportation allowances and credits was approved by our Board of Directors on June 20th, 2006. We are seeking increases in both allowances and credits that exceed those in our petition dated May 2nd, 2006, to reflect our current costs resulting from increases in diesel fuel, which have -- which we indicated would occur in our petition.

We appreciate the granting by the California Department of Food and Agriculture of our request and the opportunity to readdress milk movement incentives. In our opinion, the hearing results of the January 31st, 2006, public hearing on these same issues will result in more distant milk movement to the Southern California Class 1 market at a significant additional cost to the overall producer pool.

Transportation allowances (ranch to plant movement) and transportation credits (plant to plant) movement are important milk movement incentives to ensure a more orderly marketing of milk to the Class 1 markets. Milk producers are responsible under our California regulated system to absorb the transportation costs to provide milk to deficit Class 1 marketing areas throughout the state.

Transportation costs continue to increase since the last hearing. The most apparent is the escalating diesel fuel costs, but increases of have occurred in wages, insurance and employee benefits, especially health care coverage. Our testimony today incorporates all of these costs up to and including the recently received notification by Kings County Truck Lines of higher diesel fuel costs Effective June 15th, 2006, which is attached to our testimony as an Exhibit A.

Our testimony addresses the hauling costs to two fluid processors we supply in the Bay Area (Alameda County) and the numerous fluid processors in the southern California area, where the higher need is for milk movement incentives. We will be consistent with our past underlying objective that producers should be responsible for local hauls, and transportation allowances and credits should compensate those producers or plants that service the needed Class 1 market from outside local areas. These incentives should be from the closest available production area, thereby discouraging milk movement from distant locations and minimizing the cost to the producer pool in California.

CDI carries the largest responsibility to supply and balance the southern California Class 1 market. And we are very aware of the milk movement difficulties and costs to supply that market.

Our recommendation for changes only in the transportation allowance to the pooling plan for market milk are as follows:

And the Pooling Plan Section 921.2(a): For plants located in the Bay Area receiving area, which shall consist of the counties of Alameda, Contra Costa, Santa Clara, Santa Cruz, San Francisco, and San Mateo: From 0 to 99 miles, 27 cents; over 99 miles through 199 miles, 32 cents; over 199 miles, 33 cents.

Now, off the written testimony. We did not include the Bay Area in our request for a hearing. But the rates that we are asking for here are consistent with what we asked for at the -- in the January 31st hearing on the same subject. The rates that are here are exactly those rates that were in our testimony at that hearing.

921.2(e): For plants located in the southern California receiving area, which shall consist of the counties of Los Angeles, Orange, Riverside, and Ventura:

Number 1, for milk shipments from Los Angeles, Santa Barbara, San Diego, Imperial, Kern, Tulare, Kings and Fresno counties. One additive there is the Los Angeles area. There is milk that travels more than 89 miles from a Los Angeles County dairy into the Los Angeles area. And by not including -- by the changes that I'm asking for here by different counties, I needed to include Los Angeles as a county that would receive the transportation allowance.

From 0 to 89 miles, 11 cents per hundredweight. This is also consistent with my testimony in January of the request of 11 cents on that mileage bracket. Over 89 miles through 109 miles, 38 cents a hundredweight. This is a 6-cent increase cost from the original petition that we gave for this hearing. Over 109 miles through 139 miles, 55 cents per hundredweight. That's a 2-cent increase. And over 139 miles, 74 cents per hundredweight, which is a 4-cent increase.

For milk shipments from San Bernardino and Riverside County. This is a new separate county listing trying to address the problems in the high desert north of the Los Angeles -- northeast of the Los Angeles area. From 0 to 89 miles, 11 cents, which is consistent with the other areas; and over 89 miles, 38 cents, which is consistent with the over 89 through 109 miles in number 1.

This is, again, a 6-cent increase from the original request that we had at the last hearing.

For milk shipments from all other areas to try to allow for shipments from any area in to southern California over 139 miles is 74 cents.

For plants located in the San Diego receiving area, which shall consist of the County of San Diego: From 0 to 89 miles, 11 cents a hundredweight; over 89 miles, 38 cents a hundredweight, which again is a 6-cent increase from our hearing testimony in January, but also consistent with the mileage brackets in the other areas that we're asking for.

Justification and supporting documentation for the above changes are as follows:

We supply the Bay Area from Marin, Sonoma, Merced, Stanislaus, and San Joaquin Counties and are requesting to increase the allowance to 27 cents per hundredweight, or just -- or a penny a hundredweight, which represents our blended cost increase over the local haul rate. The local haul rate for Merced, Stanislaus, and San Joaquin Counties is .2825 per hundredweight from the California Milk Transport and the delivery to the Bay Area is .5675 per hundredweight listed on Exhibit A, Hauling Rates - Kings County Truck Lines. We rarely haul more than 99 miles to the Bay Area, but have increased the higher mileage brackets the same amount as we did the under 99.

In regards to southern California receiving area changes have occurred in the mileage brackets from the last two hearings that are very concerning to us and encourage CDI to deviate from our current practice of prioritizing more local milk for Class 1 markets. Our concerns are as follows?

We have approximately 250,000 pounds of milk in San Diego County. That is 110 to 121 miles from the Class 1 markets in the Los Angeles area. Without our recommended changes, this milk will have an incentive to move to a Riverside County cheese plant. The mileage bracket applicable to the San Diego County milk prior to 2004 changes, which was two hearings ago, was 90 to 139 miles at a rate of 43 cents her hundredweight, which at that time covered the cost to move milk to Los Angeles over local deliveries.

Current allowance of 20 cents per hundredweight for 89 to 122 miles simply is far short of covering costs, which will eventually eliminate the availability of this milk to move to Los Angeles and require CDI to haul more milk out of Tulare County at a higher transportation allowance.

Likewise, CDI has almost 200,000 pounds of milk in San Bernardino County, 110 to 120 mileage from Los Angeles markets that will be attracted to a San Bernardino County cheese plant that will ultimately cost more producer cool dollars. Our recommendation to separate San Bernardino County as a supply county is consistent with previous hearing positions to not overcompensate the San Diego County producers.

The hauling rate from Barstow area in the San Bernardino County to Los Angeles is today 68 cents a hundredweight for our members. And our recommendation of 38 cent a hundredweight allowance results in a net producer haul cost of 30 cents per hundredweight, which is very close to the hauling cost of producers throughout the State.

A side note on that, today those producers in that area have a net hauling cost with the adjustments that have been made because of diesel fuel in the last several months of like 3 cents a hundredweight.

The last justification for adopting our mileage bracket recommendation and rates is south Kern County milk moving into the Los Angeles market. It is indisputable that this area is and will continue to be the main source for fluid needs in southern California. The most recent decision to expand one of the mileage brackets to 122 miles places a 35 cent per hundredweight disadvantage for

CDI to move south Kern County milk, which in our -- amounts to 650,000 pounds of milk a day that's in that bracket to the Los Angeles area. This needs to be corrected as soon as possible, or CDI will have to divert this milk to Tulare via backhaul -- which we have a significant amount of backhauls going by that area -- and move Tulare County milk to Los Angeles at a 45-cent per hundredweight additional cost to the producer pool under the current pooling plan.

Transportation allowances need to be established based on milk movement patterns in a marketing area, and CDI understands those patterns in southern California as well as anyone.

Our approach has always been to service the fluid market as efficiently as possible at the least overall cost to the producer pool within our contractual obligations. We cannot stress enough that this hearing panel gives serious consideration to our recommendations to avoid a less efficient and more costly milk movement system for the southern California market.

In regards to transportation credits, we recommend the following changes only to the stabilization plans for market milk:

And this is Section 300.2 of the Stabilization and Marketing Plan. Designated supply County of Los

Angeles to the designated deficit county movement, a maximum deduction per hundredweight of 37 cents per hundredweight.

Tulare County, designated supply county, to designated deficit counties of Los Angeles, Orange and Ventura, 76 cents a hundredweight. And to Tulare County as a designated supply to the deficit counties of Riverside and San Diego Counties, 85 cents.

We have not requested any changes in the Fresno and Kings to the Los Angeles or Riverside area. We again believe that the closer-in milk should be moving to the market and there should be a disincentive, and so we've left those rates at 72 in to Los Angeles, Orange, and Ventura and 80 cents in to Riverside and San Diego, again to discourage milk from those areas to go south.

We are very disappointed in the last hearing results reducing the transportation credit from Los Angeles County to Riverside County from 34 to 26 cents. In 2004, CDI was fortunate enough to acquire a fluid processor that was seeking a change, which included as one of their options to source a supply from out of state.

We felt it important enough for all producers in California and CDI to retain this Class 1 processor, but needed to expend $500,000 in processing of equipment to facilitate this processor's requirements. At that time, CDI had two options of where to locate this equipment, either Tipton or Artesia. We have plants in both of those locations. Our analysis showed that it would be less costly to producers to supply from Artesia in southern California than Tipton in Tulare County and equally important that it was a closer source of standardized product to better service this processor.

The change to a 26 cent credit places this processor at an economic disadvantage to the time they decided to continue to service their milk requirements from a California operation. We testified at the January 31st, 2006, hearing to increase their credit from 34 to 36. And due to subsequent increases in diesel fuel costs, we are today asking for 37 cents. So it would be going from 26 now to 37 cents.

For those participants today that have previously questioned the overall cost of transportation allowance from South Valley to southern -- to Los Angeles, plus a transportation credit from Los Angeles to Riverside, we offer the following examples:

Under Example No. 1, in the 109 to 139 category, which is Kern County, the transportation allowance to southern California is 55 cents, and the transportation accredit from L.A. To Riverside is 37. Now, these numbers all incorporate our requested amounts. They're not the current levels, but they are what we are requesting the changes to be in both the allowances and the credits.

Over 139 miles, which was one of the exhibits the Department presented to us at the pre-hearing workshop, which is Tulare County into southern California, the transportation allowance is 74. Again, transportation credit adjusted for our numbers is 37, which is a dollar eleven -- total cost to move milk from the Tulare area into Los Angeles and then from Los Angeles to, in this case, Riverside is a dollar eleven.

The Example No. 2, when you look at the transportation credit from Tulare to Riverside -- again, ours being -- the new one being 85 cents, the price differential being 27 cents -- the total cost to the pool is a dollar twelve. We compare this dollar twelve to the 92 cents movement from ranch to plant and then plant to plant.

In the above examples, we are using our recommended changes, as I stated, to both the transportation allowances and credits. And since the heavy majority of CDI's milk movement is within the 109 to 139 mile bracket, at least currently it is, there is a 20 cent per hundredweight advantage to the producer pool revenue under Example No. 1 in that mileage bracket versus Example No. 2. And one of the additional documents the

Department gave after the pre-hearing workshop, if you would incorporate our requested changes, there still is a 12 cent difference -- 12 cent advantage to move from ranch to plant, plant to plant, then going from plant to plant into Riverside with product. This is a sizable difference that can accommodate questions on what is the proper rate for comparison or that standardized milk is the ultimate product -- or that standardized milk is the ultimate product being delivered via the transportation credit.

The other recommended changes to transportation credits are simply cost related, continuing our past position of a slight disadvantage from Tulare County and a higher disincentive from Fresno and Kings Counties in movement to the Los Angeles area.

Our current hauling costs from Tipton to Los Angeles is a dollar nine and a half per hundredweight less the 27 cent differential, or 82 1/2 cents is our cost when we move milk out of the Tipton plant, versus a 76 cent recommended transportation credit from Tulare. So there is -- we've built in a factor of a disincentive from Tipton, which is the south Tulare County plant, and as you go further north that disincentive would increase.

Both transportation allowances and credits are important tools to assure an orderly marketing of milk within our State Pooling Plan and Stabilization and

Marketing Plans for market milk.

A couple of other notes I'd like to state that are not in my written testimony: There will be some discussion today on transportation credits on condensed. Our cooperative is -- it was not in support of placing transportation credits on condensed at the time that it was done several years ago. However, we can continue to state that, as we did at the last hearing, that there are some contractual obligations today that have been committed. You know, based on the fact they have a transportation credit, then I think it would be difficult to remove them at this time because of those factors.

There is one significant change occurring next year, however, is one of the major plants of suppling condensed skim to southern California out of Tulare County is closing. And so there would be less product at least unless they source it from further north or from out of state. But the closer location from Tulare County that's now supplying condensed skim into the L.A. Market will be closing next -- April of next year is what they're stating.

There's another alternate proposal today from Driftwood on raising the transportation credits from Tulare into Los Angeles. You will notice we are also requesting an increase in the transportation credits, but not at the level that they're asking for because we still believe there should be a disincentive. And that would be the difference between our testimony and their testimony.

There's been other comments made in the pre-hearing workshop concerning the issue of transportation credits from L.A. on condensed skim. There isn't any movement that I'm aware of out of L.A. County on condensed skim that is getting transportation credits. It's only on standardized products and it's only to one plant, which is at Riverside. We have requested at previous hearings a transportation allowance -- excuse me -- credit from L.A. to L.A., and we were -- you know, the Hearing Panel chose not to grant that. We're not requesting that today. But there is no movement of condensed skim receiving credits within the L.A. County area other than Riverside County, and that's not condensed skim.

We hope that we have provided this hearing panel the justification for our recommendations and would like to request a post-hearing filing period to answer or clarify any questions. And timing is always an issue here. With what happened -- what's been happening with the oil price going up to 75 dollars per -- you know, we're going to probably be looking at further increases in transportation costs within the next week or two.

However, we can't project those in advance, and so we certainly encourage the Department to look, you know, at our requested amounts. They are cost justified. By the time we get them in effect, they probably will be outdated because we know our costs are going up. And, again, we want to emphasize a close look of the mileage brackets within southern California because we believe they -- you know, they really need to be changed to address the milk movement that's occurring there.

Thank you for granting this hearing and allowing CDI to testify.

And I'm glad to answer any questions.

HEARING OFFICER AYNES: Do you wish to submit this document as an exhibit?

MR. KORSMEIER: Yes, sir.

HEARING OFFICER AYNES: This will be identified as Exhibit No. 44.

(Thereupon the above referenced document was marked by the Hearing Officer as Exhibit 44.)

HEARING OFFICER AYNES: Are there panel questions?

AGRICULTURE ECONOMIST GOSSARD: Mr. Korsmeier, in your proposal for transportation allowances into southern California, since your petition in the 89 to 109 mile bracket you had a 6-cent increase in your testimony today as opposed to somewhat smaller increases for the other distances. Was there any particular reason that there was a larger increase in the 89-to-109 bracket?

MR. KORSMEIER: Yes, Mr. Gossard, it was to address the situation we have in the San Bernardino County area. Again, by our request of breaking those counties out separately and wanting to at least protect the producers in that area to the extent of any cost over and above 30 cents a hundredweight, which we believe is an average transportation cost that producers are absorbing today for local hauls, by our research finding that those producers were paying 68 cents a hundredweight, and less the 30 cents as we said in our testimony, that that's where the justification came from raising that particular bracket a little bit more than the other brackets was that movement out of San Bernardino County.

AGRICULTURE ECONOMIST GOSSARD: And on the over-139-mile bracket at 74 cents, what's the basis for establishing the 74 cents?

MR. KORSMEIER: That was based on our costs that -- of Kings County Truck Lines and that -- you know, that we're moving milk into that area with some -- with some disincentive.

AGRICULTURE ECONOMIST GOSSARD: In your testimony you felt as regards transportation allowances there were two major concerns you had. One was with the mileage brackets as they currently exist as the -- and then your proposal -- the other was with having separate brackets for San Bernardino County.

Which of those two concerns is the greatest for you?

MR. KORSMEIER: It would be the mileage brackets, not the San Bernardino County. But, again, Mr. Gossard, the justification there is the -- most of the producers in that high desert, that Barstow area, are CDI producers. And you might be questionable that we're actually testifying to reduce their transportation allowance. But our Board of Directors has difficulty in a group of producers that have either a negative haul or no haul when the rest of them have, you know, some local haul. So that's why we continue to try to zero in on that.

And if you noticed from the past hearings, we've tried a little -- you know, we had a different approach. This time we're breaking San Bernardino and Riverside out. But when you look at the movement within that southern California market, that the mileage changes that we're asking for are more significant to us than the San Bernardino issue.

AGRICULTURE ECONOMIST GOSSARD: Turning to the issue of transportation credits, the bottom of page 5. Your example -- this is for 3587 milk, I take it?

MR. KORSMEIER: Yes, it is.

AGRICULTURE ECONOMIST GOSSARD: Your example shows from Kern County an allowance of 55 cents and then an additional 37 cents for the transportation credit, for a total of 92 cents. Now, that's for one particular processor who's taking tailored products. But isn't it true that their competitors in southern California would only be getting a 55 cent allowance to attract milk directly from a ranch? So doesn't that 37 cents give them a competitive advantage over their competitors?

MR. KORSMEIER: I would -- I think that there will be individuals here testifying today to maybe clarify that. But my response would be that I think that that's -- that it's not an advantage because there's a transportation cost to move milk out of our Artesia plant to Riverside that is in excess of that 37 cents. They're actually having to absorb some additional freight costs. Now, this is over and above any standardization costs or anything else that we -- you know, we apply to that sale.

I think today that hauling costs from Artesia to Riverside is 51 cents a hundredweight. And so that processor is absorbing a 14-cent-a-hundredweight cost in hauling. So this -- the credit that we're requesting does not cover a hundred percent of the cost of that haul.

AGRICULTURE ECONOMIST GOSSARD: At the end of your testimony when you went off your prepared statement, I believe you said that you were not aware of any condensed skim moving from an L.A. plant and getting credit; is that correct?

MR. KORSMEIER: Any condensed skim from an L.A. plant to an L.A. plant, yes.

AGRICULTURE ECONOMIST GOSSARD: Well, okay. An L.A. plant to an L.A. plant is ineligible for credits?

MR. KORSMEIER: Right. Which we had requested at one of the previous hearings. But there had been discussion amongst industry people, Mr. Gossard, that there was -- the concern was that there were -- you know, condensed skim was, you know, getting transportation credit in southern California, albeit not even L.A. County, but Riverside, San Bernardino, any of the others. I don't believe there's any transportation credit being applied to condensed skim movement in southern California.

AGRICULTURE ECONOMIST GOSSARD: All right. But there could be transportation credits for some condensed skim for organizations other than your own, is this correct?

MR. KORSMEIER: That's correct.

AGRICULTURE ECONOMIST GOSSARD: Okay. Finally, you'd made reference to the prior hearing several times. And one of the issues that the Panel brought up at the last hearing was the basis for payment for credits and allowances. It's currently in dollars per hundredweight. The Panel recommended reviewing the concept replacing dollars per hundredweight basis to a dollars per solids-not-fat basis. Had you given any thought to that concept?

MR. KORSMEIER: We haven't studied it to the degree that we need to before we would recommend any changes, no, sir.

AGRICULTURE ECONOMIST GOSSARD: Thank you very much.

No further questions.

HEARING OFFICER AYNES: Are there further Panel questions?

All right. Next would be the alternative petitions. Representatives of Driftwood Dairy, Western United Dairymen, Security Milk Producers, and Dairy Farmers of America will now receive 30 minutes to each present their alternative petitions.

Testimony will be received in the following order: Driftwood Dairy, Western United Dairymen, Security Milk Producers, and Dairy Farmers of America.

And would the representative from Driftwood

Dairy -- would you state your name and spell your last name for the record.

All right. Do you wish to submit this document as an exhibit?

Okay. That will be identified as Exhibit No. 45.

(Thereupon the above referenced document was marked by the Hearing Officer as Exhibit 45.)

MR. DOLAN: My name is James Dolan D-o-l-a-n.

HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?

MR. DOLAN: I do.

HEARING OFFICER AYNES: You may proceed.

MR. DOLAN: Mr. Hearing Officer and Members of the Board Panel. My name is James Dolan and I represent Driftwood Dairy in El Monte, California. We historically purchased a good percentage of our milk from the southern San Gabriel -- southern San Joaquin Valley.

In the past the state has maintained a disincentive to buy milk plant to plant from the South Valley. The Chino basin milk supply is decreasing drastically while overall demand increases. Approximately 80 percent of the cows that were milked in the area during its prime have moved elsewhere. Also, there's a large local cheese plant that can absorb most of milk made available to it, production in the southern California basin is continuing to decline at an ever-increasing rate.

Studies have been made that shows that plant-to-plant movement from South Valley to southern California is just as efficient, if not more so, than ranch to plant from the Valley to southern California. It allows you to move milk components like skim needed for the market without having to haul all the unwanted fat.

We purchase our South Valley milk in Tulare at South Valley prices and must be able to move it to southern California at no disincentive if we are to continue to be a competitive viable member of the southern California supply chain.

The current system does not do that. The haul rate from Tulare to our plant currently is a dollar seventeen and three-quarter cents a hundredweight and the transportation credit is only 69 cents and the area differential was 27 cents. We cannot compete efficiently with the 19 1/4 cent her hundredweight shortfall. We came out of the last hearing with a 10 1/4 cent shortfall, and it has continually increased. We request that the credit be increased to 21 3/4 cents to 90.75 cents, which will leave us expense neutral for local milk.

We feel the pool is responsible to see that milk moves to the fluid market in a manner that allows equal raw product costs under equal terms. Increasing transportation credit to eliminate disincentives to move southern California -- milk into southern California will help insure an adequate and timely supply of milk for the southern California fluid market.

Thank you.

HEARING OFFICER AYNES: Are there Panel questions?

Thank you for your testimony.

MR. DOLAN: Thank you.

AGRICULTURE ECONOMIST GOSSARD: Mr. Hearing Officer, did you enter his document as a record?

HEARING OFFICER AYNES: That was No. 45 -- entered as Exhibit No. 45.

Next will be Western United Dairymen.

Do you wish to submit this document as an exhibit?

MS. LaMENDOLA: Yes, please.

HEARING OFFICER AYNES: This will be admitted as Exhibit No. 46.

(Thereupon the above-referenced document was marked by the Hearing Officer as Exhibit 46.)

HEARING OFFICER AYNES: Would you state your name and spell your last name for the record.

MS. LaMENDOLA: Tiffany LaMendola L-a-M-e-n-d-o-l-a.

HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?

MS. LaMENDOLA: I do.

HEARING OFFICER AYNES: Please proceed.

MS. LaMENDOLA: Mr. Hearing Officer and members of the Hearing Panel. My name is Tiffany LaMendola. I'm the Director of Economic analysis for Western United Dairymen. Our association is the largest dairy producer trade association in California, representing approximately 1100 of the state's dairy families. We are a grass-roots organization headquartered in Modesto, California. An elected Board of Directors governs our policy. The Board of Directors met May 19th, 2006, and June 16th to approve the position I will present here today.

Our testimony for this hearing is very similar to our prior testimony for the January 2006 hearing. Though we are not privy the many of the dynamics surrounding milk movement, we have done our best to address the issues that were not resolved or were created as a result of the last hearing.

The current system: When the pooling system was implemented in California contractual agreements between producers and processors were eliminated and incentives to ship to a fluid plant, likely a longer distance, were removed. Producers made the commitment to assure supplies to the Class 1 market in exchange for the benefit of all producers sharing in the revenues from the higher valued Class 1 sales.

Thirty-seven years have passed since the implementation of the pooling system. Many things have changed and some dairymen now in business never experienced the pre-pooling climate. This has led to the situation in which the need for a statewide pooling system that distributes milk sales revenues equitably among producers is not evident to some.

Many producers look at their own hauling and fuel costs and wonder why they should also be required to fund transportation incentives. Transportation costs to dairymen have increased in step with those of processing plants, yet there's no way for many producers to recoup coop the added expenses. This is a hard concern to address. Those producers in support of funding the transportation incentive system would likely offer the following points:

1. Contrary to the belief of some, transportation allowances are paid to producers, not plants, supplying the Class 1 market. The added costs

incurred to ship to a fluid plant is somewhat offset by the allowance and is returned to the producer either through their cooperative or directly in the milk statement if they're an independent shipper. The revenues from the sale of those producers' milk to the Class 1 markets are shared equally by all producers through the pool. Allowances on ranch-to-plant shipments constitute the largest share of the cost to the pool from the transportation system. The use of transportation credits on plant-to-plant shipments has declined rapidly.

2. The system is not perfect. However, it serves the function of helping to maintain California's Class 1 markets and returning those dollars to the pool. Even though Class 1 utilization in the state has declined, it is still in a producer's best financial interest to protect the Class 1 market. According to Department figures, Class 1 alone returns nearly ten times the cost of the transportation system of the pool.

3. Producers who service the Class 1 market should be rewarded. Without incentive to ship to the more distant fluid plants, supplies available to the Class 1 market would likely dwindle. Processors would be forced to pay larger over-order premiums to attract the milk or would likely opt to obtain milk from out-of-state sources or relocate outside of California. The rational manager

will do whatever costs his plant the least amount of money.

Though there is support and rationale to maintain the current transportation system, upon review of the materials released by the Department in preparation for this hearing, our Board of Directors raised several concerns. It is apparent there are flaws in the current milk movement system that need to be addressed. However, it is also apparent there are no easy solutions.

Dynamic changes continue to evolve within the state. While this hearing does not deal with major changes, it is becoming clear that at some point the industry may need to seriously consider how we can adapt the system and meet current and impending challenges. For instance, evidence showed that southern California milk supply continues to decline. The cost of the transportation incentive program has surpassed 2 million in recent months, a cost far in excess of what anyone would like to see. At the same time that southern California milk supplies are declining and more milk is being shipped greater distances, there is a great deal of local southern California milk used for non-fluid purposes, such as cheese. As availability of milk in southern California deteriorates, how will we continue to address the need to supply the Class 1 market yet minimize cost to the pool?

Our board agrees with and continues to support guidelines set forth by the Department with respect to setting transportation incentives. First, producers who serve the Class 1 market ought to be rewarded; two, the closest milk to the market ought to move first; and, three, a regulated system ought to attempt to minimize costs to the pool.

We strongly encourage the Department to stay committed to these basic tenets in their review of the proposals at hand and in their recommendations to the Secretary.

We agree with basic guiding principle that has historically been used: Through transportation allowances, shippers should be made indifferent when choosing to ship the milk locally or to the more distant, and presumably higher usage, plant. We also agree with the Department that a shortfall should continue to exist in the structure of any area receiving transportation allowances to encourage the closest milk to move first.

Western United's Alternative Proposal:

Our alternative proposal calls for the elimination of transportation credits for condensed skim. The movement of condensed skim into southern California has undergone changes in the last several years. Using

Department data, appropriate credit rates and differentials, one can estimate the pounds of condensed skim moved between various regions during the different time periods. While a great deal of condensed skim was once supplied to southern California from the south San Joaquin Valley, it appears that this is no longer the case. Data indicates that nearly all the condensed skim demanded from southern California is now supplied from within that region. It should be noted that this change occurred even with a condensed skim credit available to move the product from the south San Joaquin Valley.

The Department released Figure 106 at the pre-hearing workshop. It compares to cost to the pool of moving condensed skim via transportation credits to moving a comparable amount of ranch milk via transportation allowances to southern California. At first blush, this figure seems to make the argument that credits for condensed skim should not be eliminated because it is less costly to the pool to move condensed skim via credits than moving a greater amount of ranch milk via allowances. However, while we do not question the accuracy of this figure, we do feel that it does not represent options that are currently available. Recall the current supply situation for condensed skim in southern California. It's not being supplied by the south San Joaquin Valley.

Rather it is being supplied from within southern California. The ranch milk is already being moved to southern California and then subsequently manufactured into condensed skim.

Our proposal does not change the competitive situation already in place. Our proposal does not result in a shift of condensed skim being supplied by, say, Tulare to being supplied from within southern California. Even with credits available, not to mention the differential to plants in southern San Joaquin Valley, the change has already taken place. Figure 106, Tulare to southern California, depicts an option that is proven unsustainable for reasons we are not privy to. Likewise, in figure 206, Kern to southern California, we are unaware of any movement of condensed skim from Kern County to southern California and transportation credits are not available.

So given the current dynamics, how do we follow the basic tenets outlined above, namely, minimizing costs to the pool? Clearly, eliminating the credit for condensed skim is an easy answer. Given that producers are already funding the transportation of ranch milk to southern California, they should not also be required to fund the transportation of a manufactured product plant to plant in southern California. In fact, data from the

Department indicates there is currently some milk that receives transportation allowance and then a transportation credit, namely on condensed skim supplied from Los Angeles. This is beyond the current intent of the transportation incentive system developed in California, increases the cost to the pool, and was even a concern of the Department in the last Hearing Panel report.

The Hearing Panel report from the January 2006 transportation hearing notes that, quote, it is inefficient for the milk movement system to provide transportation allowances for ranch-to-plant shipments when the intermediate usage is condensed skim, end quote. They go on to note that it is the ranch-to-plant allowances that are the real problem, but they also explain that, quote, lowering the allowances to address this condensed skim issue would however result in disruption of milk use for fluid purposes, end quote.

It seems as though the Department chose to reduce the transportation credit for milk and condensed skim within southern California. The apparent problems created by this change are addressed later. It seems that the elimination of credits for condensed skim may have been a less disruptive first step and would not have had any detrimental impacts on the movement of standardized milk in that area.

In addition, and to address the condensed skim supplied to the Bay Area that are eligible for credits, it must be recognized that producers already fund a fortification allowance on condensed skim used for fortification purposes. In fact, the receiving plant that purchases condensed skim for fortification receives a credit from the pool of 9.8 cents per pound of solid nonfat. According to the May 2006 pool report, 5.8 million pounds of solid nonfat were eligible for the condensed allowance. Using the Department's estimation of 31.6 percent solid nonfat test in condensed skim, the solid nonfat pounds equate to 18.4 million pounds of condensed skim per month. Over the 12 months this adds up to over 220 million pounds of condensed skim used for fortification purposes. Given that during the period January '05 through April '06 a monthly average of 4.5 million pounds of condensed skim was eligible for transportation credits, one can assume that a great deal of that product also received a condensed fortification allowance.

Producers should not be responsible for moving a manufactured product plant to plant that is already subsidized through fortification allowances. The goal of assuring supply to the Class 1 market is sufficiently provided through transportation allowances and transportation credits on milk.

In the last Hearing Panel report concern was raised over the declining share of California-supplied condensed skim. It declined from 90.9 percent share to an 84 percent from November '04 to December '05 was cited. From the data available to us prior to finalizing our testimony, we noticed an increase in the average monthly pounds of condensed skim eligible for transportation credits. The monthly averages are in the table below.

This information makes it appear as though the average monthly volume of condensed skim eligible for credits has increased by nearly one million pounds from the most recent period when compared to November '03 to October '04 when the credits for condensed skim were first implemented. As we understand, condensed skim supplied from out-of-state sources is not eligible for transportation credits. So given the increase in condensed skim supply from California noted in the table above, coupled with a declining share in total condensed skim supplied to southern California, we can only conclude that condensed skim supplied from out of state has grown more than California-supplied condensed skim. This is based on the fact that credits on Bay Area bound condensed skim has remained static.

Though we are unable to get specific data before finalizing our testimony, if we are correct that out-of-state sourced condensed skim has increased, then we must ask why. Are there competitive situations in place that supersede the benefit that credits for condensed skim provide? Does providing credits on condensed skim really work to capture those sales for California suppliers or is it just costing the pool money? We really don't know, but we ask the Department to consider these questions in their deliberations.

We urge the Department to eliminate the transportation credit for condensed skim. Its existence, even coupled with the differential, could not maintain what the Department has shown as a least costly plant-to-plant movement of condensed skim. Given the current dynamics in the industry, if the Department chooses to follow their basic tenets -- tenet of reducing costs to the pool, then credits on condensed skim will be eliminated. Clearly, the tangible savings offset any potential costs to the pool.

CDI Petition:

We support the transportation allowance bracket and rate adjustments requested by CDI in their petition dated May 2nd, 2006. To the best of our knowledge, the requested changes are cost justified and necessary to maintain an adequate supply of milk to the Class 1 markets.

We are supportive of CDI's recommended changes to the southern California supply counties and brackets. We understand the changes aim to encourage milk to move to Class 1 markets rather than local manufacturing plants. Apparently, three supply regions to the southern California fluid market are of particular concern: South Kern County milk, Barstow milk and San Diego milk. Specifically, the allowances currently available to those areas have made it attractive for producers in those areas to ship to their local cheese plant rather than continue to supply the more distant fluid market.

We will let CDI provide testimony as to the exact competitive issues that have resulted. We do, however, understand that it is important that this milk continue to supply the Class 1 market. In its absence, milk from further distances -- northern Kern County and Tulare County -- will move at a greater cost to the pool.

Also, the changes requested by CDI deal with certain areas in San Bernardino County being overcompensated for their hauling costs through transportation allowances. Under no circumstances should producers make money off transportation allowances. This is not the purpose of the transportation allowances and unnecessarily increases costs to the pool.

We also agree with CDI's proposal for the furthest-out brackets in the San Diego receiving area. According to the Department, nearly all the milk moved with transportation allowances is less than 100 miles from the qualifying plant. There is no reason for larger rates for further out brackets if the milk from those areas is not needed to sufficiently supply the one processing plant located in San Diego County. The Hearing Panel report from the last hearing suggests a potential need for further out milk may exist at some point in the future. However, that is not yet the case. An increase in the rate can be later made if conditions warrant.

We are appreciative of the Hearing Panel's attempt after the last hearing to both recognize increased hauling costs for the furthest-out bracket into southern California but also attempt to minimize costs to the pool. They recommended the use of a weighted average of the distant less local haul in Kern and Tulare county, with no shortfall for Kern County and a shortfall for Tulare County. Given the larger rates for this bracket proposed by CDI, Security and DFA, we can assume there is a similar observation on the part of the processors that the current 65 cent allowance is not sufficient. We are hopeful that testimony will be provided to explain the current situation, as our organization is not involved in milk movement decisions. We do, however, reiterate our support of the basic tenets of moving the closest milk first and reducing costs to the pool.

We recognize that CDI's proposal today may include increased allowance rates over those contained in their original petition to reflect increased diesel prices. At the last hearing our board supported cost justified increases to transportation allowances. They recognized the increases in hauling costs that had occurred since the last transportation hearing in 2004. However, our board cannot support another rate increase at this time. The last increases to the transportation allowances were effective April 2006, just three months ago. Since the last hearing producers have experienced a rapid deterioration in milk prices coupled with increased input costs. The latest hauling cost figures released by the Department are dated August 2005. Though diesel -- a large portion of hauling costs -- prices have fluctuated, it's unclear to us the exact deviation from those experienced in August 2005. In looking at the diesel price data provided by the Department in Figure 2, it is apparent that current diesel prices are similar, at least within a range, to those in August 2005. We realize that other components of hauling costs have likely changed, but we don't know exactly what impact they've had on current hauling rates. Given that producers are currently under extreme financial stress, we cannot take the risk of taking on additional costs to the pool without access to complete hauling data.

With respect to transportation credits on milk, excluding condensed skim, our board supported cost justified increases to transportation credits at the last hearing insomuch as the resulting credits did not cost the pool more money than moving the equivalent amount of milk via allowances.

Data presented by the Department in Figure 101 and 102 indicates that given the current rates and differentials, it is still more cost effective to move milk via allowances rather than credits. Likewise, the combination of allowances and credits were even more costly to the pool. However, Figure 201, which shows from Kern and Tulare to southern California, does show a savings from the allowance-plus-credit system over the cost of credits alone. However, the allowance plus credits still exceed the cost of only allowances. Under the CDI proposal depicted in Figure 202, a similar cost analysis is at play with allowances being the least costly method to the pool of moving milk to southern California. Of course, if the receiving plant in southern California can only accept standardized milk, then the dynamics change. Here, ranch ranch-to-plant milk may not be an option. We are mindful that this is a situation at play and, therefore, the allowances plus credits may be the least costly alternative. We are hopeful that the plants supplying these accounts will provide more details in their testimony.

In the last Hearing Panel report, a noted goal was to establish a level playing field to those plants that have a combination of both allowances and credits to those that have only credits. As a result, the panel recommended some changes to the credit system. Apparently one of the changes, notably the reduction in the credit within southern California, fostered a competitive situation that has made it difficult for CDI to supply one of their accounts in Riverside within the same economic conditions that were at play when the larger credit was available. They have explained that the solution to their problem would result in either the potential loss of the account to out-of-state sources or the need to move milk from further distances to supply the account, at a potential increase cost to the pool. We are not privy to the competitive situation or specific details involved here and will leave it to CDI to provide testimony to these points.

Our board, however, is aware of the potential threat of losing valuable Class 1 sales to out-of-state sources. This is an outcome they do not want to see materialize. Luckily, for 2005 and for the first five months of 2006, there have not been any year-over-year increases in out-of-state shipments in to California. We have been told that over the past couple of years California processors were successful in acquiring some Class 1 contracts. Even so, according to Department data, 15 percent of our fluid milk is supplied from out-of-state sources. Unfortunately, this milk is not pooled and the loss of the Class 1 revenue associated with this milk results in a direct reduction in producer income. Any further loss in Class 1 sales to out-of-state suppliers should be avoided.

We do not support Driftwood Dairy's alternative proposal. The increase proposed by Driftwood Dairy far exceeds the transportation credit established as a result of the recent transportation hearing. As a result of the last hearing, the credit was increased by 7 cents a hundredweight. We cannot support another 10.25 cent increase. We imagine a credit this large would completely eliminate the historic shortfall as well as greatly alter the relationships between allowances and credits. The proposed increase does not appear to be cost justified and greatly exceeds the level of 69 cent recently established by the Department.

An additional point worth noting: According to the Department, historically transportation -- quote, transportation credits offset some of the cost of hauling milk assigned to Class 1 usage from plants in designated supply counties to plants in designated deficit counties, end quote. We know standardized milk moved plant to plant via transportation credits likely demand a premium in the marketplace. Should the Department decide to make no adjustments to the current credit rates, this premium, which is not pooled, can be used by processors toward the cost of hauling standardized product plant to plant.

We do not support Security's alternative proposal. The requested substantial increase in transportation allowances for the furthest-out brackets suppling southern California goes against the basic principle of encouraging the closest milk to move first. The requested increases are larger than those proposed by CDI and run the risk of costing the pool unnecessary dollars. A shortfall larger than that proposed by Security in this bracket should be maintained.

And, finally, we cannot support the allowances increases requested by DFA at this time. Our reasoning was outlined above in our discussion on the CDI allowance proposal. In addition, the proposed rates are larger than those contained in the CDI petition.

We thank you for the opportunity to testify and request the option to submit a post-hearing brief.

HEARING OFFICER AYNES: Does the panel have questions?

Thank you for your testimony.

Next would be Security Milk Producers.

Do you wish to submit this document as an exhibit?

MR. PERKINS: Yes, I do.

HEARING OFFICER AYNES: Your document is admitted as Exhibit No. 47.

(Thereupon the above referenced document was marked by the Hearing Officer as Exhibit 47.)

HEARING OFFICER AYNES: Would you state your name and spell your last name for the record.

MR. PERKINS: Hank Perkins P-e-r-k-i-n-s.

HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?

MR. PERKINS: I do.

HEARING OFFICER AYNES: You may proceed.

MR. PERKINS: Mr. Hearing Officer, members of the Panel. My name's Hank Perkins and I represent Security

Milk Producers Association, a cooperative of dairymen serving the Class 1 market in southern California. The Board of Directors of SMPA have reviewed and approved this testimony.

We would like to thank the Department for calling this hearing so quickly to address milk movement incentives.

Our proposal deals solely with transportation allowances into the southern California receiving area. After further review, we altered our request for the two highest mileage brackets, lowering them by 5 cents and 6 cents a hundredweight. As evidenced by the diesel fuel graph presented by the workshop -- presented at the workshop, fuel prices continue to rise. Since January 1, 2006, our haul rate from Tulare to Los Angeles has risen by 9 cents per hundredweight. This increase is 100 percent attributable to the fuel surcharges. We utilize three independent freight companies to haul milk from the Tulare area into the Los Angeles basin. All three have a base rate of 90 cents a hundredweight and impose a fuel surcharge on top of that rate. As of June 23rd, 2006, the surcharge was 28 percent, giving us an effective rate of a dollar fifteen a hundredweight. Subtracting a local haul rate of 30 cents and our proposed allowance of 80 cents, we are left with a 5-cent shortfall as is customary with the northernmost milk. We have attached freight bills corroborating these rates.

Hauling rates from Kern County into Los Angeles -- into the Los Angeles area are 70 cents a hundredweight plus a 24 percent fuel surcharge. The total rate is therefore 87 cents. And after subtracting the local haul, it is 57 cents. We are therefore asking the allowance -- asking that the allowance for the over 109 through 139 miles bracket be raised to 57 cents per hundredweight. Invoices showing these rates are attached to our written statement.

California Dairies, Inc., has requested changes to the mileage brackets for the southern California receiving area. SMPA has no objections to the new brackets proposed by CDI.

Although not included in any of the proposals today, SMPA is interested in the concept of a fuel adjuster in the transportation allowance system. Such a program would address the changes in fuel prices in a timelier manner and alleviate the need for more frequent hearings on this subject. We ask that the Department carefully consider a fuel indexing plan.

The specific language of our requested changes is as follows:

Pooling plan for market milk, Section 921.1(e):

For plants located in southern California receiving are which shall consist of the counties of Los Angeles, Orange, Riverside and Ventura:

From 0 through 89 it's 11 cents per hundredweight; over 89 through 109 is 32 cents per hundredweight; over 109 through 139, 57 cents per hundredweight; and over 139, 80 per hundredweight.

On behalf of the Board of Directors and the members of Security Milk Producers Association, thank you for the opportunity to present our testimony today. And we would like the opportunity -- the option to submit a post-hearing brief.

HEARING OFFICER AYNES: Does the Panel have questions?

Thank you for your testimony.

Next will be Dairy Farmers of America.

Do you wish to submit this document as an exhibit?

MR. STUEVE: Yes.

HEARING OFFICER AYNES: Okay. Your document is admitted as Exhibit No. 48.

(Thereupon the above referenced document was marked by the Hearing Officer as Exhibit 48.)

HEARING OFFICER AYNES: Would you state your name and spell your last name for the record please.

MR. STUEVE: My name is Gary Stueve S-t-u-e-v-e.

HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?

MR. STUEVE: I do.

HEARING OFFICER AYNES: Please proceed.

MR. STUEVE: Mr. Hearing Officer and members of the Hearing Panel. Thank you for the opportunity to testify here today. My name is Gary Stueve. I'm Vice President of Fluid Milk Operations for the Western Area Council Dairy Farmers of America. We currently market the milk of 300 member-producers in California as well as the milk from nearly 100 non-members. We market nearly one-fourth of our milk to non-Class 4 plants, with the majority of the remaining volume going to Class 4b cheese plants. Because nearly one-fourth of our milk enters non-Class 4 plants and qualifies for transportation allowances, we have submitted an alternative proposal dealing specifically with transportation allowances. Our testimony deals primarily with necessary adjustments due to changes in diesel fuel prices. We have also experienced a broad general freight increase, approximately 3.9 percent, since the date of the last hearing.

The DFA Western Area Council Board of Directors in a meeting on June 26th, 2006, has approved our proposal and resulting changes to the pooling plan. I appreciate the opportunity today to provide comments as well as an explanation or alternative proposal.

The volatility of fuel prices was well documented and roundly discussed at the previous hearing. And this volatility has continued through the first six months of the year. Although fuel prices have declined modestly in the past few weeks, diesel fuel as listed on the Department of Energy website is now 38.6 cents per gallon higher now than on January 31st, 2006, the date of that last hearing. In early may diesel fuel was 51 cents higher than January 31st.

We have provided in our exhibits the backup for the changes we feel are necessary and justified for four specific receiving areas. We also did not make any changes from when we submitted our alternative proposal to today.

In the Bay Area, Sacramento and North Bay receiving areas our proposal calls for primarily fuel-related increases and correlates with the support documents we have provided, including a listing of fuel prices from the DOE website.

In southern California our proposal calls for a combination of fuel-related increases and mileage bracket adjustments. The mileage brackets established as a result of the last hearing have created a problem in the South valley whereby at least one of our producers now only qualifies for a 20-cent transportation allowance to southern California, while the actual freight cost is the same as all other producers in the area. The milk and milk like it has a built-in disincentive to supply the Class 1 markets in southern California. The haul cost, including fuel surcharge, for this milk to southern California Class 1 plants is approximately 87 to 88 cents. We are proposing, as is CDI and Security, that the two middle mileage brackets be reconfigured to better reflect the differentiation in the hauling costs in the South valley while still allowing the high desert area to be fairly represented.

I would like to point out that I inadvertently left out San Bernardino County in the southern California receiving area on our original proposal. It's our intention to include San Bernardino County in the southern California receiving area.

We have attached and provided to the Panel as exhibits several back-up documents, and I would like to briefly explain at this time what we have provided.

Document No. 1, with arrows in the right-hand margin, is simply the retail on highway diesel prices provided by DOE, where we marked the diesel fuel costs at the date of the last hearing, at their peak in May, and this week's price as listed on the website.

Document No. 2 is the same document we submitted at the last hearing. This is the fuel surcharge program that we have in place for about 60 percent of our member milk. Document 2 is the January fuel surcharge.

Document No. 3 is the same fuel surcharge for July, again represents about 60 percent of our milk. I added a column in the far right that represents the change from January to July.

Document 4 and 5 is another fuel surcharge program we have in place with a hauler that hauls about 10 percent of our milk. Again, on the bottom of Document 5 I added a box that details the changes from January to July.

Document No. 6 is a copy of a freight bill for the south Kern County area. I have highlighted or marked the one producer that only receives 20-cent transportation allowance coming to southern California; while obviously he is included in a group of producers in the same general area and has the same general haul costs.

Document No. 7 is the co-op member transportation allowance sheet that's provided by the Department for this particular producer, illustrating the 20-cent transportation allowance that he receives coming to southern California. Again, this is a southern Kern County producer. The actual driven miles of this producer are actually higher than producers who are listed as higher under the constructive mileage system that the state employs.

Document No. 8 is the same type of document from a Barstow high desert area producer. Illustrating, again, the 20-cent transportation allowance. The reconfiguration of the brackets for southern California that we are supporting and proposing would raise that to 36 cents and make that milk more competitive going to Class 1.

And, lastly, Document No. 9 is simply the cover page for our primary hauler, indicating an increase that went into effect March 1st. And this was roughly, across the board represented about 3.9 percent. I would like to point out the bullet point number 1 -- or the first bullet point on that. This is becoming a considerable issue, and that being traffic in the urban areas. The Class 1 plants tend to be located quite some distance from the milk in the highly urbanized areas. Traffic is becoming a major issue, and we're going to continue to see freight rate increases and additional cost to supply Class 1, among other things, based on traffic.

I would like to thank you for the opportunity to testify today. I do request the opportunity to submit a post-hearing brief and would be happy to try and answer any questions the Panel may have.

HEARING OFFICER AYNES: Does the panel have any questions?

Thank for your testimony.

Members of the public may now testify, with each speaker provided with 20 minutes, followed by questions from the Panel.

To ensure the accuracy of today's hearing, I request that each witness swear or affirm to tell the truth and nothing but the truth and to state their names and spell their last name, identify the organization that they represent, the number of members in that organization and the process by which the organization finalized the testimony.

The first one's from Dairy Institute of California, William Schiek.

Do you wish to submit this document as an exhibit?

DR. SCHIEK: I do.

HEARING OFFICER AYNES: And would you state your name and will you spell your last name for the record.

DR. SCHIEK: Yes, my name is William Schiek. That's S-c-h-i-e-k.

HEARING OFFICER AYNES: This will and mid as

Exhibit No. 49.

(Thereupon the above referenced document was marked by the Hearing Officer as Exhibit 49.)

HEARING OFFICER AYNES: And you represent the Dairy Institute of California?

DR. SCHIEK: That's correct.

HEARING OFFICER AYNES: How many members does that organization have?

DR. SCHIEK: We have approximately 40 member companies that we represent.

HEARING OFFICER AYNES: And what was the process by which your organization finalized your testimony?

DR. SCHIEK: It was approved unanimously by our Board of Directors.

HEARING OFFICER AYNES: Please proceed.

DR. SCHIEK: Do I need to swear?

HEARING OFFICER AYNES: Oh, I'm sorry. You do need to swear.

(Laughter.)

HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?

DR. SCHIEK: I do.

HEARING OFFICER AYNES: Okay.

DR. SCHIEK: Mr. Hearing Officer and members of the Hearing Panel. My name's William Schiek. We went through a bit of this already. I'm an economist for Dairy Institute of California.

We have appreciate the opportunity to testify today and comment on the proposals by CDI, DFA, Security, Driftwood and Western United Dairymen which are under consideration at this hearing.

We commend the Secretary for his willingness to consider updating the regulatory framework in which our members operate to make it reflective of current marketing conditions.

At issue in this hearing are proposed changes to the milk movement incentives contained in the pooling plan and the stabilization and marketing plans for northern and southern California milk marketing areas.

The broad purposes of milk movement programs have been identified as follows:

First, to assure an adequate supply of milk to plants which provide Class 1 and Class 2 usage products to consumers.

Second, to assure that higher usages have a priority in terms of milk movement incentives to produces.

And, three, to encourage the most efficient movement of milk to fluid usage plants.

The enactment of milk pooling in 1969

fundamentally altered the relationships between Class 1 processors and suppliers. Prior to pooling, the higher plant blend price that was paid by Class 1 plants provided a positive incentive to attract milk to the highest use. During the discussions leading up to the Gonsalves Milk Pooling Act, producer representatives, in exchange for processor support, made a commitment to ensure that Class 1 plants would be served. From the beginning, it was recognized that fluid plants by virtue of the higher minimum prices that pay should be able to procure necessary milk supplies without having to subsidize the haul cost to their plants.

The current system of transportation allowances and credits in California developed after a period where milk movement incentives were limited primarily to area differentials and location differentials on quota milk, a system which was somewhat similar to the location differentials employed in Federal Orders. Over time the consolidation of milk marketing areas, growth in the milk production and changing production and distribution patterns, and the unique California geography necessitated new milk movement incentive mechanisms.

The transportation credits and allowances both came into being in the early 1980s. The general principle behind transportation allowances was that they should compensate dairymen for the difference between the local haul to the manufacturing plant and the longer haul to the more distant fluid milk plant in the metropolitan area. In the absence of such incentives, producers would have an incentive to ship their milk to a manufacturing plant and a disincentive to serve the fluid milk market. When transportation allowances fully compensate producers for the difference between the local haul and the long haul to fluid plant, producers will be indifferent as to where they ship their milk.

With respect to transportation credits, the principle was to compensate the milk supplier for the cost of shipping milk from the supply plant to the deficit area plant after accounting for any difference in the marketing area Class 1 differentials. Historically, the transportation credits and allowances have been set at levels that do not fully compensate handlers for their shipment costs. A shortfall in hauling compensation with respect to more distant milk was supported by Dairy Institute in the past based on the assumption that it would encourage more efficient milk movements. The extent of the shortfall needed to encourage orderly movement has been and continues to be a subject of debate. As I will discuss in more detail later, we believe the application of the shortfall concept should be limited to the most distant milk supplies only.

We continue to believe that a milk movement incentive system is necessary in order to meet the statutory mandates and guidelines governing our industry. In recent years the industry has continued to evolve and has undergone considerable structural change. Consolidation of supplying cooperatives and fluid milk processors has changed milk production and distribution patterns. It is therefore appropriate to review the existing system of transportation allowances and credits to determine if changes are necessary. This usual review is made all the more critical when we consider the changes in milk supply structure which are taking place across the state, but nowhere more impressively than in southern California. Given the rapid and ongoing contraction of the southern California milk supply, the implications are obvious. To supply food processing plants in the L.A. basin, rapidly increasing quantities of milk are going to be trucked in from outside the area. While the growing milk supply in Kern County is an obvious choice to supply the market, it has become apparent that not all of this milk is available to serve the southern California fluid market. Milk has been moving to southern California from Kings, Tulare and Fresno counties to meet Class 1 demand, and it appears likely that increasing quantities from these areas will continue to be needed in the future.

We believe that it is consistent with the purposes of milk stabilization, and with the commitments made by producer leadership at the inception of milk pooling, that milk should be attracted to Class 1 plants at order prices. Unfortunately, some have held the incorrect view that the sole purpose of the Class 1 price differential is to enhance producer income, instead of recognizing that in part the differential was designed to assure that Class 1 markets are served. Another notion that has been troubling to Dairy Institute's membership has been the belief expressed by some that over-order premiums should be relied upon as a primary means to attract milk for fluid purposes. We continue to maintain that the existing order prices paid by processors provide more than enough revenue to attract milk to Class 1 and mandatory Class 2 purposes, and that the marketing and pooling plans should provide the milk movement incentive mechanisms which are adequate to ensure that those uses are served. When we consider the relatively high Class 1 price differential in California relative to the state's very low Class 1 utilization, it is even more obvious that processors should not need to subsidize the haul to their plants.

In general, Dairy Institute supports proposals that seek to make cost-justified adjustments to the transportation allowances and credits. Costs for diesel fuel have increased significantly over the past few years. In recent months the price has become quite volatile. The aftermath of the Gulf Coast hurricane sent diesel prices soaring in the autumn of 2005, but prices were retreating almost as dramatically by year-end. And we can refer to Attachment 1, which is a graph of diesel fuel prices in California.

Since the beginning of 2006, diesel fuel prices, following price movements in the crude oil market, have rebounded to the level of last year's highs. One thing that appears to be clear is that current transportation allowances and credits are not reflective of the new energy price realities.

Dairy Institute has no access to broad data that are reflective of current milk movement costs across the state. We are relying on others presenting testimony here today to enter relevant information about the magnitude of current hauling costs into the record.

Instead, we argue for the application of sound economic principles in setting the allowance and credit rates, basing them on the most recent rate and fuel cost information available to the panel at the time of this hearing. The volatility of diesel fuel prices makes this task difficult. Currently diesel prices appear to be 6 to 8 percent above the average level seen during August 2005, the last time that CDFA's hauling rate survey was conducted.

Not withstanding the uncertainty in fuel prices and hauling rates, Dairy Institute believes that transportation allowances and credits must be adequate to encourage milk to move to higher-use plants in deficit areas. Inadequate rates lead to California Class 1 processors being unable to compete favorably with manufacturing plants for milk supplies and put them at a competitive disadvantage with respect to out-of-state processors. In order to secure the local Class 1 market for California producers, transportation allowances and credits must be adequate to draw milk without transportation subsidization by the buyer or supplying cooperative.

Dairy Institute continues to support the principle that transportation allowance rates should be set equal to the difference between the cost of the local haul and the cost of the haul to the higher-use plants in metropolitan markets. A slight shortfall should apply only to the most distant milk brackets to encourage milk that is located closer to the market to move first. With regard to milk moving into southern California, there should be no shortfall on milk coming from as far away as Tulare or Kings counties, because of the increasing volumes of milk that are necessary to supply the southern California markets from those areas.

The transportation allowance system was meant to address the narrow problem of how to attract milk to fluid plants in metropolitan areas at order prices. However, when setting both allowance and credit rates, equity among competing plants in attracting milk supplies is something that needs to be considered. This is particularly true when the application of milk movement incentives confers advantages on some Class 1 plants over others. If these advantages would not have existed in the absence of milk movement incentives, then the incentives should be adjusted to both: 1) redress the inequitable impacts; and 2) ensure that fluid milk plants are adequately served. With the foregoing in mind, Dairy Institute's position is that fluid plants operating within a market should not be disadvantaged relative to each other in the procurement of nearby milk supplies.

Dairy Institute supports the principle that transportation credits should be set equal to the haul cost less any area differential. In the distant past we have advocated that shortfalls should apply to the more distant milk to encourage more efficient milk movements.

However, in recent years we have advocated full compensation for all but the most distant milk to encourage competition in supplying the Class 1 market. Full compensation is especially important for shipments from the South Valley into southern California as there has been an historic pattern of plant-to-plant milk movements. Furthermore, the alternative supplies from southern California and Kern County do not seem to be adequately available to meet all southern California's needs.

Shortfalls and credit rates should only be employed for the most distant milk, not the milk in relatively closer areas that regularly serves the southern California Class 1 market.

Transportation credits are currently available on shipments of milk and condensed skim to plants in southern California, including Orange, Los Angeles, Ventura, San Bernardino, and San Diego counties, and to plants in the Bay Area. Credits are not available on shipments to plants from the North Bay and -- shipments to plants in the North Bay and Sacramento receiving areas, although there appears to be no valid reason why plants in those areas should not be eligible if their operations utilize plant-to-plant shipments of milk or condensed skim.

As we have stated before, equity among Class 1 plants competing for milk supplies needs to be considered when studying transportation credit rates. But the Department should also be cognizant of the impact of its past policies on plant investment decisions when setting a future direction for milk movement incentives.

Comments on other proposals:

First, California Dairies. Dairy Institute supports cost-justified allowances and credits. And CDI's proposals for transportation allowances appear to be cost justified based upon the hauling rate information they have supplied. We note that in the past CDI has called for a shortfall for ranch-to-plant and plant-to-plant shipments of milk from the most distant mileage brackets to southern California's receiving area. Given the changing nature of the milk supply in southern California, with less local milk available and longer distance hauls being increasingly utilized, we believe there should be no shortfall in allowance rates except for milk originating beyond Kings and Tulare counties.

CDI's call for an adjustment in the mileage brackets for southern California's receiving area cannot be disputed by Dairy Institute. The representatives of cooperatives operating in that region who are involved in arranging for ranch-to-plant shipments there are in the best position to determine the appropriate brackets. To the extent that closer-in milk has been made less likely to be attracted to Class 1 uses than more distant milk, this situation needs to be corrected.

We agree with CDI that a differentiation of the southern California supply areas is warranted given the very low hauling rate that is currently being experienced by producers in the Barstow area of San Bernardino County. With regard to CDI's proposed rates for San Diego, such changes are acceptable if they do not result in plants in San Diego having to subsidize the haul to the plant.

With regard to northern California, we note that CDI has not presented any changes to current rates. That was based on their petition. Obviously there were some changes there. But we point out that DFA, which supplies milk to plants throughout northern California, has proposed increases in transportation allowance rates on milk moving into the Bay Area, North Bay, and Sacramento receiving areas. To the extent that these changes are cost justified -- and based on Mr. Stueve's testimony, they appear to be -- they are supported by Dairy Institute.

CDI's transportation credit proposal would retain a shortfall with respect to plant-to-plant movements into Los Angeles and Riverside counties from Tulare. We have continued to argue that shortfalls on such shipments should be eliminated. And we argue again that since milk has moved regularly from more than 139 miles, Tulare County, to serve the Class 1 market in southern California, shortfalls should be negligible especially since milk supplies in southern California continue to wane. Other proposed changes by CDI to transportation credits appear to be cost justified and we would support them. And that includes the rate from L.A. to Riverside.

Dairy Institute generally supports DFA's proposal to increase transportation allowances in the Bay Area, Sacramento, and North Bay receiving areas. In the past DFA has proposed indexing transportation allowance rates to changes in fuel prices. Dairy Institute believes this concept merits further study. Given the incredible price volatility we have been experiencing, indexing may be the only means to ensure that fluid plants will be adequately served. While we are supportive of the indexing concept, we would like to see how well the index's projected rates track with actual hauling rates before supporting any particular indexing proposal. Also, while the index could be a useful method for ensuring that the transportation allowance and credits stay current, it will not put a need to the -- it will not put an end to the need for hearings such as this one, because other factors can and often do lead to changes in milk movement costs.

Dairy Institute supports the allowance rate changes proposed by Security to the extent that they are cost justified and conform to the general principles we have outlined earlier in our testimony.

We note that the proposed allowance rate for the over 139 miles bracket appears to overcompensate producers for the difference between the local haul and the southern California long haul cost based on the August 2005 CDFA hauling cost data. While we note that costs appear to have increased since then, the proposed increases in the allowance rates are quite large relative to current rates and should be carefully reviewed by the Panel. We also note we've heard in Security's testimony that they reduced some of those longer distance rates. So obviously they addressed that to some degree.

Driftwood's proposal to increase transportation credits appears to be cost justified. We have argued in the past that shortfalls on plant-to-plant movements from the South Valley to southern California be eliminated. And so we are supportive of Driftwood's proposal so long as it is cost justified.

Western United has proposed the elimination of transportation credits on condensed skim. It is unclear from the CDFA analysis presented at the pre-hearing workshop that Western United's proposal will result in a net reduction in the total cost of the transportation allowance and credit system to the pool. As more and more milk must be drawn from the South Valley to meet southern California's needs, it seems possible that maintaining the transportation credits for condensed skim could reduce the future costs to the pool. Dairy Institute does not support the elimination of transportation credits on condensed skim at this time.

I also note that we continue to support the call provisions. There were no proposals to change those. But we just continue to affirm that we feel those are important.

And I'd like to thank you for this opportunity to testify. I would like to have an opportunity to file a post-hearing brief. And I'm willing to answer any questions the panel has.

Thank you.

HEARING OFFICER AYNES: Panel questions please.

MILK POOLING BRANCH CHIEF LEE: Yes, Mr. Schiek, I have a question regarding on page 4 of your testimony. You've highlighted in the middle of the page: "However, when setting both allowances and credit rates, equity among competing Class 1 plants in attracting milk supply is something that needs to be considered."

Are there any examples that you'd like to present to the panel?

DR. SCHIEK: No, I think this -- this is a principle that arose and we spent a lot of time looking at back at the time when the discussion was adding Marin and Sonoma County into being ineligible for transportation allowances. And we were looking at the rates. And some of the hauling rates in that area at the time seemed to kind of defy logic. And so the point was, if you just went with the data, you would have ended up with rates for -- or compensation in the form of allowances that would have then begun to impact competitively some of the surrounding areas like Solano and Sacramento. And so at that time we said, "Look, if you're going to set these rates, you're going to adjust rates for this new area, you need to basically look at how it impacts the milk supply arrangements and competitive issues amongst areas where they're competing for the same milk supply." So it's more of a principle situation. I'm not specifically pointing out any area where that's not true. But it's just one of those issues that we would like the panel to keep in mind when they're setting rates.

MILK POOLING BRANCH CHIEF LEE: Okay. Thank you.

HEARING OFFICER AYNES: Are there further panel questions?

AGRICULTURE ECONOMIST GOSSARD: Mr. Schiek, you said that a shortfall should only apply to the most distant milk mileage brackets. But you also said that the milk coming from Tulare should have no shortfall. Since the Tulare milk falls in the most distant mileage bracket in southern California, does that mean that for any milk going into southern California there should be no shortfall but there may be a need for a shortfall in the distant brackets in northern California?

DR. SCHIEK: No, I think, you know -- my point there is that milk has regularly moved from Tulare down into southern California to supply that market. We feel like that milk is needed, and therefore we don't feel like there needs to be a shortfall there. Obviously, you know, we don't want to be subsidizing milk from, you know, Sacramento to L.A. or things like that. But I think where there's a regular supply arrangement like that, that we believe that there needn't be a shortfall.

One of the issues that I think I addressed in the testimony as one of the reasons that we're supporting that is the issue of maintaining competitive choices for southern California processors. We used to support shortfall from that region. I'd say that was probably prior to the establishment of the Southern California Milk Marketing Agency that was in effect in the late nineties and early part of the 21st Century. I think that pressed upon our membership the need to foster competition in supplying the southern California market. Because we do believe that the Class 1 differential that's paid by Class 1 processors in California provides enough revenue based on our utilization and the availability of milk in this market. We don't feel like processors should be paying a lot more than that in the form of unjustified service charges. So we believe in keeping a competitive supply in place.

AGRICULTURE ECONOMIST GOSSARD: You also addressed a balance between the use of transportation allowances and then transportation credits. So, you have stated that the -- say, the allowances in Tulare County should be -- it's a local list -- distant haul list local, no shortfall. The transportation credit from, say, Tulare County should be a hauling cost less the Class 1 differential. But what if one of those two methods are more expensive to the pool to move the same quantities of milk? Are we talking about equity to the processor -- competing processors or equity in terms of how the money from the Class 1 differential is funding those two methods?

DR. SCHIEK: Certainly obviously I represent processors. So that's my primary analysis. When you want to talk about efficiency, you know, I'm not -- in terms of the data that I've seen, it's not necessarily clear to me that one method is more efficient than the other. Certainly you could talk about cost to the pool. But as I also said, I think you have to take into account the fact that investments have been made and that results in bricks and mortar and steel and other assets being made based on past policies of the Department. And I think it's very disruptive to businesses when a decision is made based on one set of policies and then those policies are reversed. It kind of tends to strand assets.

And so I think you have to take into account the industry as it exists. And it's a delicate balancing act, I know, but I think you guys are up to it.

(Laughter.)

AGRICULTURE ECONOMIST GOSSARD: Finally, at the last hearing in the Panel report the Panel mentioned that the current basis is -- for allowances and credits is dollars per hundredweight, but the Panel recommend reviewing the concept of replacing dollars per hundredweight basis to a dollars per pound solids nonfat basis.

Have you given any thought to that concept?

DR. SCHIEK: A little. As you know, we've had other hearings going on here. And we haven't gotten our policy group together to look at this issue in any detail, so I'm not really prepared to comment on it. It's something though I think we all would like to look at in the future. But at this point we're not advocating any change to the current system in terms of that.

AGRICULTURE ECONOMIST GOSSARD: And, more importantly, you don't have any particular comments one way or the other on that concept at all?

DR. SCHIEK: No.

AGRICULTURE ECONOMIST GOSSARD: Thank you very much.

HEARING OFFICER AYNES: Are there further panel questions?

Thank you for your testimony.

DR. SCHIEK: Thank you.

Let's see. We've already heard from Driftwood Dairy.

Next would be Milk Producers Council.

Do you wish to submit this document as an exhibit?

MR. VAN DAM: Yes, I do.

HEARING OFFICER AYNES: All right. The document is admitted as Exhibit No. 50.

(Thereupon the above referenced document was
marked by the Hearing Officer as
Exhibit 50.)

HEARING OFFICER AYNES: Would you state your name and spell your last name.

MR. VAN DAM: Yes, my name is William C. Van Dam. Last name is spelled V-a-n, new word D-a-m.

HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?

MR. VAN DAM: Yes, I do.

HEARING OFFICER AYNES: And let's see. You're representing Milk Producers Council. What's the number of members in that organization?

MR. VAN DAM: We have approximately 100 dairy members.

HEARING OFFICER AYNES: And what was the process by which the organization finalized your testimony?

MR. VAN DAM: This testimony was prepared under the guidelines and actions taken by the Board of Directors. And those guidelines were reaffirmed at our June 13th, 2006, board meeting.

HEARING OFFICER AYNES: Very good. You may proceed.

MR. VAN DAM: Thank you.

Mr. Hearing Officer and members of the Panel. My name is William C. Van Dam. I am the Executive Director of Milk Producers Council, a producer trade association representing about a hundred dairies, with slightly over half of our members' production located in southern California and the balance, but a growing portion, located mostly in the southern portion of the Central Valley.

Both our organization and the southern California milk market are going through a transition as the milk supply moves out of the Chino area to other areas. Our members have a clear interest in the outcome of this change and how the system manages the movement of milk to the Class 1 market.

Our testimony today is guided by long-term policy positions of Milk Producers Council as affirmed at our June 13th Board meeting.

Although we are seeing signs of a slowing of the net reduction of the cows in the Chino area, it is a process that will continue. It is likely to take quite some time, with the result eventually being the same in the Chino area as has occurred in Los Angeles, Ventura, and Orange counties: No local milk.

The expected longer-term result of this decline is that all the milk needed for southern California Class 1 market must come from greater distances. However, the longer-term result is already occurring. Currently there is enough milk delivered from northern California ranches (See Figure 9 of the background material supplied by the CDFA) to meet the Class 1 needs of southern California.

This happens in spite of a still very significant supply of milk in the Chino area, which economic models would suggest should be delivered to Class 1 plants of southern California.

Chino is the closest and most logical supply to deliver to that market. However, it is critical to note that the Chino area is in decline, and the factors that are dictating the decline are not going to be changed by transportation considerations.

We find it easy to support the basic principle that the closest milk should move to the Class 1 plants and that the cost of the system should be minimized, as has been stated by several other witnesses. However, we reach a contrary and counterintuitive conclusion, because the situation in southern California is such that it is not appropriate nor in the best interests of producers to emphasize the delivery of close in milk to Class 1 plants. It is better to accept higher current costs in this system now in order to set up a long-term solution for the future. In addition, the capacity of the manufacturing plants in southern California are an important part of the overall plant capacity of the state. On this same topic in his post-hearing brief dated February 3, 2006, Gary Korsmeier wrote the following:

"I do not believe even a 20-cent per

hundredweight increase in transportation allowance will change milk movement patterns because of existing long-term commitments and supply requirements of other than Class 1 processors. More local milk to Class 1 will naturally occur only when and if manufacturing capacity is reduced."

It is better to embrace the inevitable and concentrate on putting together a transportation incentive system that will move the needed milk from the areas that will surely be the long-term source of milk for Class 1 plants in southern California: Kern, Tulare and King counties.

When changes of the magnitude caused by the decline of milk in the Chino area occur, it is time to examine the basic assumptions. Key among these is the assumption that producers alone must foot the total cost of delivery to market. At the very basic level of transportation economics is the concept that users of products must pay the cost of getting the product to their location brands (when the supplier has an alternative local market). This can be done as a higher price or as a direct payment of the freight bill. Either way, the cost of a product is increased by the cost of delivery. Over the past few years the cost of the pool -- to the pool of moving milk to the Class 1 market has skyrocketed as the volume of milk moved has increased.

As recently as 1996 less than 1 million pounds of milk per day were moved from the Central Valley to southern California. That number currently exceeds 8 million pounds per day. The double whammy of higher freight costs plus the dramatic increase in the volume being moved long distances has caused alarming increases in the cost to the pool. In an unregulated environment cost changes of this magnitude would drive changes in the price to the customers.

The cost, however, is what it is. And also it is the future and the dairy industry must deal with it. The Department has called a Class 1 price hearing for December. It seems to us that the changes in the location of milk supplies requires an upward adjustment in the Class 1 price that should cover some or all of the added costs to the pool. We will, I am sure, so suggest at that hearing.

In the meantime, we would suggest that sellers of bulk milk consider surcharges on deliveries of milk to plants. As transportation costs increase, it has become common practice to tax surcharges on top of the normal fees and prices to cover the added costs. And we had plenty of testimony to that effect today. Milk prices are always minimum prices, and reasonable, unavoidable costs can and should be passed on. In the case of transportation costs, the increases apply equally, or nearly so, to all customers. The surcharges will therefore not change the competitive relationships between milk suppliers.

Milk Producers Council does not support the addition of indexing to the formulas. While it appears that indexing is not included as a topic at this hearing, we are not sure what it is covered by some of the more general language included in the call of the hearing, and therefore wanted to make sure to post our objection.

Our association is not in the business of moving milk and we are not privy to the details of milk shipments. Therefore, we must defer to the testimony and judgment of those who do. In addition, the Department has access to data that can be used to determine the veracity of the proposals being put forth and of the supporting data entered into the record.

We do not object to adjustments based the real increases in costs, but we urge the Department to carefully verify any adjustments made and to follow the basic principles outlined in previous hearings and in your own documents including the findings from the previous hearing. Two of our favorites are: Every producer should pay a minimum net hauling price about equivalent to that of a local producer delivering to a local plant and 2) that credits available to plant-to-plant movement should never exceed the allowances available to producers shipping milk the same distance.

This hearing may well set a record for how little time has passed since a previous hearing on the same subject. If this quick call is because of an error in findings of the previous hearing or because of the infamous unintended consequences of those same findings, we would support a quick finding designed to correct those specific issues.

And, finally, we support the position of Western United that transportation credits should not be applied to condensed skim. It is a value added product that is by definition a high value product that can be transported long distances for comparatively low cost per unit of value.

Condensed is eligible for transportation credits only when delivered to Class 1 plants, where it is used for fortification of fluid milk. At least I hope that's so. The pooling system allows significant and, we feel, adequate fortification credits to plants. Getting transportation credits and fortification allowances on the same condensed is a form of double dipping that should not be allowed.

This concludes my prepared testimony. We request the right to submit a post-hearing brief.

HEARING OFFICER AYNES: Does the panel have questions?

MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: I do.

Mr. Van Dam, on page 2 of your testimony you talk about the industry needing to basically embrace what the future of the milk supply for southern California is and focus on that. By that, one could assume that perhaps we should eliminate the 10-cent transportation allowance for local milk moving into bottling plants in southern California.

Do you guys -- does your organization have any thoughts on that?

MR. VAN DAM: Well, I can assure you it would be an unpopular in my board room.

(Laughter.)

MR. VAN DAM: But you do have a point.

MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: And you also -- a little further down on the same page you talk about when market conditions change that prices should be adjusted and that hauling costs should be bore perhaps through higher prices or as a direct payment of the freight bill.

Does your organization view the Class 1 price as a higher price and a price that should be used to move that milk to the market?

MR. VAN DAM: That is the way we're viewing it. The Class 1 funds the premium dollar generated by that all go into the pool. That's the money that's drawn upon to pay the transportation allowances. And therefore it's a direct relationship. You put more money in the pool, we have therefore covered a big chunk of these added costs. This is a rather monumental shift that's going on right now, and it requires rethinking of some of the basic things. There has been a relationship that existed in the past that is, we believe, no longer correct and we just to have to put more money into the system to cover the costs of that. And this isn't the place we can decide that. I'm just making a point.

MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: When looking at the additional revenues, would you base those additional revenues on the current Class 1 price compared to future Class 1 prices that you might recommend, or would you look at the current 4A price, 4B price compared to Class 1 prices: I guess trying to measure -- I'm trying to get at how would you measure that additional revenue?

MR. VAN DAM: Okay. The Class 1 prices are typically set and they average some amount of money over the class 4A-4B prices. The alternative for producers in the valley is to get those prices. And we need to make the difference larger because we have to pay more as a system to get the milk to market. So it's just having a higher incremental price between the 4A-4B and the Class 1 price in southern California.

Did I answer your question? I tried, but --

MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: I believe you did, yes.

MR. VAN DAM: Thank you.

HEARING OFFICER AYNES: Any further questions?

Thanks for your testimony.

MR. VAN DAM: Thank you.

HEARING OFFICER AYNES: Next organization would be Land O'Lakes.

Do you wish to submit this document as an exhibit?

DR. GRUEBELE: Yes, I do.

HEARING OFFICER AYNES: All right. Your document will be admitted as Exhibit No. 51.

(Thereupon the above referenced document was
marked by the Hearing Officer as
Exhibit 51.)

HEARING OFFICER AYNES: Would you state your name, spell your last name for the record.

DR. GRUEBELE: James W. Gruebele G-r-u-e-b-e-l-e.

HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?

DR. GRUEBELE: I do.

HEARING OFFICER AYNES: And the organization you represent is Land O'Lakes?

DR. GRUEBELE: That is correct.

HEARING OFFICER AYNES: How many members in that organization?

DR. GRUEBELE: Thirty-three hundred nationally; 275 in California.

HEARING OFFICER AYNES: And what was the process by which the organization finalized your testimony?

DR. GRUEBELE: Board of Directors approved it.

HEARING OFFICER AYNES: Very good. Would you proceed.

DR. GRUEBELE: My name is James W. Gruebele, Dairy Industry Consultant, 7196 Secret Garden Loop, Roseville, California 95747. I am testifying on behalf of Land O'Lakes, Incorporated.

Land O'Lakes is a dairy cooperative with over 3300 dairy farmer member owners. The cooperative has a national membership base whose milk is pooled on the California State Program and six different federal orders.

Land O'Lakes' members own and operate several cheese, butter powder and value added plants in the upper Midwest, East and California. Currently our 275 California member owners supply us with over 15 million pounds of milk per day that are processed in our plants in Tulare and Orland.

Transportation credits. Land O'Lakes supports an adjustment in the transportation credit based upon cost-justified changes in freight costs in moving milk from the South Valley into southern California Class 1 milk markets as reflected in the alternative proposal submitted by Driftwood Dairies. The increase is necessary because of the changes in freight rates on moving milk from the surplus area (Tulare) to the deficit market (southern California). Since the last hearing in January 31st, 2006, the freight rate from Tulare to our customer in southern California has increased by 11 1/2 cents per hundredweight.

I have a document that's attached from Kings County Truck Lines. And you will note that the freight rate at the top, Driftwood, El Monte, effective 6/1/2006, is a dollar seventeen and three-quarters. And that was the same rate that Driftwood Dairies testified to early.

The transportation credit into Los Angeles was adjusted to 69 cents per hundredweight as of the last hearing. Based upon the freight rate increases since the last hearing, we support the Driftwood proposal to increase transportation credits from Tulare County to Los Angeles County. Based upon the changes in the freight rate, the Driftwood proposal makes sense.

Condensed skim. Land O'Lakes continues to support the inclusion of condensed skim in the transportation credit program because it encourages the movement of milk components in an efficient, cost-effective manner. As a result of the last hearing the Department determined that transportation credits should continue for condensed skim. Nothing as happened to change that conclusion. In fact, the Department conducted an analysis comparing the cost of supplying the solids-not-fat using transportation allowances to the cost of providing those same solids used in condensed skim along with a transportation credit. The Department analysis of the previous hearing pre-hearing workshop showed that supplying solids for fortification for fluid milk products using condensed skim on a plant-to-plant basis from Tulare to southern California Class 1 plants was much more efficient than supplying those solids on a milk equivalent basis on a ranch-to-plant basis. This higher level of efficiency results from the removal of water from the condensed skim.

Figure 106 in the document entitled "Analysis of Proposals for Transportation Credits" in the June 13th, 2006, pre-hearing workshop shows the comparative costs of supplying solids for fortification using condensed skim (with transportation credit) and whole milk (with transportation allowance). Again, the results of the Department analysis showed that it was more efficient to supply the solids for fortification of Class 1 products using condensed skim from Tulare County as compared to moving raw milk on a ranch-to-plant basis.

The panel report for the June 3rd, 2003, hearing provided the following reasons for the continuation of the transportation credit for condensed skim:

1) Continuation of the transportation credit program for condensed skim enables processors the opportunity to secure condensed skim from an additional California source, namely LOL;

2) Facilitates the effective movement of condensed skim used for Class 1 fortification;

3) Assists California's fluid processors in meeting California's fluid milk standards; and

4) Allows California condensed skim to remain a competitive source of solids-not-fat for fortification.

As a result of a post-hearing analysis, the Panel determined that the cost of the transportation credit for condensed skim to the pool was less than the revenues that would be lost from decreased sales of condensed skim sales. The Panel expressed concern about any proposal that would affect the competitiveness of California condensed skim.

LOL agrees with the Panel's reasoning. Market conditions have not changed and the transportation credit should continue for condensed skim.

Transportation allowance proposal. LOL suggests the following principles should be applied when considering milk movement issues:

1) Encourage local milk to move first.

2) Transportation allowances should be based upon differences between local and long-distance haul to Class 1 markets.

3) Do not overcompensate producers serving Class 1 markets.

4) Make cost-justified changes to transportation allowances.

Based upon the above principles, the producer supplying a Class 1 market would be responsible for paying on a net basis a local haul to a manufacturing facility. For producer equity, these principles should be applied to all supply areas in southern California including the high desert.

After applying the transportation allowance, producers in the high desert should be responsible to pay the equivalent of a local haul. If that is not the case, then the transportation allowance in this area should be changed.

We also support CDI's proposal to adjust the transportation allowances for milk shipped from Santa Barbara, San Diego, Imperial, Kern, Tulare, Kings and Fresno counties to the southern California receiving area consisting of the -- if you take into account the local haul of 29.75, you end up with a 55-cent transportation allowance proposed by CDI. So we support and endorse that particular proposal.

We believe that these changes in transportation credit and allowances make California more competitive with out-of-state sources of milk and provide more producer equity.

We do not object to cost-justified changes in the transportation allowances in other modest brackets for milk supplied from South Valley into southern California.

Conclusion. The amount of out-of-state milk has been growing. We need to do everything we can to make California more competitive with out-of-state sources. Making the needed cost-justified adjustments to the transportation credit and allowance program can help to do this.

This concludes my testimony. I would like the opportunity to file a post hearing brief.

Thank you.

HEARING OFFICER AYNES: Are there panel questions?

AGRICULTURE ECONOMIST GOSSARD: Dr. Gruebele, you made reference to a Figure 106 in the analysis of transportation credits for the pre-hearing workshop. And you said that that figure showed that it was more efficient to move condensed skim plant to plant. By more efficient, did you mean less costly to the pool?

DR. GRUEBELE: Yes.

AGRICULTURE ECONOMIST GOSSARD: And on that same issue of the cost of moving condensed skim, the Panel in the prior hearing said that one thing that might be considered is moving from a dollar per hundredweight basis for allowances and credits to a dollars per pound of some fat and solid -- to a dollar per pound solids nonfat basis. Has LOL given any thought to that since the Panel recommendation?

DR. GRUEBELE: I would say not enough of come to any conclusion after this hearing.

AGRICULTURE ECONOMIST GOSSARD: Thank you very much.

HEARING OFFICER AYNES: Further questions?

MILK POOLING BRANCH CHIEF LEE: Yes, Dr. Gruebele. Tom Gossard had asked several of the other witnesses the same question, is regarding the concept of changing the way we calculate transportation credits and allowances. Rather than using a hundredweight basis, we use a component basis solids and --

DR. GRUEBELE: I think he just asked that question and I just answered it. We haven't really considered -- we really haven't considered that to any great degree. And certainly the Board has not been aware of any analysis that we've done, because we haven't made a sufficient analysis to come to any conclusion.

MILK POOLING BRANCH CHIEF LEE: Thank you.

HEARING OFFICER AYNES: Any further panel questions?

Thank you for your testimony, Dr. Gruebele.

Let's see. Next organization will be Crystal Cream and Butter Company.

Do you wish to submit this document as an exhibit?

MS. HALE: I do.

HEARING OFFICER AYNES: Your document is admitted as Exhibit No. 52.

(Thereupon the above referenced document was

marked by the Hearing Officer as
Exhibit 52.)
HEARING OFFICER AYNES: Would you state your name and spell your last name for the record?
MS. HALE: It's Sharon Hale H-a-l-e.
HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?
MS. HALE: I do.
HEARING OFFICER AYNES: And the organization -- are you actually representing the organization?
MS. HALE: We're a proprietary company --
HEARING OFFICER AYNES: Okay.
MS. HALE: -- organization. But if your question's leading to how the testimony was developed --
Yes.
MS. HALE: It was written by me and approved by our President.
HEARING OFFICER AYNES: Very good. You may proceed.
MS. HALE: Thank you.
Mr. Hearing Officer and members of the Panel. My name is Sharon Hale, and I'm Vice President, Dairy Policy and Procurement, for Crystal Cream & Butter Company. Our administrative offices are located at 1013 D Street, Sacramento, California. We currently operate two

production facilities in Sacramento and purchase the majority of our milk from the independent dairy farmers located in the surrounding counties. Supplemental milk is sourced from cooperatives as needed to satisfy fluctuating market demands.

2006 has been a year of change for Crystal. And in the two months since this hearing was announced the focus of this testimony has shifted multiple times as situations changed, new facts appeared, and opportunities presented themselves. I thought a simple timeline of events might offer the best understanding of the evolutionary process that supports the comments I'm about to make.

When the notice of public hearing arrived in my e-mail on May 3rd, 2006, I was on vacation. Upon my return, I quickly scanned the hearing announcement, saw that the petition from CDI dealt with milk movement in southern California, knew hauling rates for our dairies had not changed since the January hearing, noted the hearing date of June 2nd, 2006, one day after the manufacturing allowance hearing, and breathed a sigh of relief. Our testimony would be short and sweet -- reference our January statement, indicate producer haul rates were unchanged, and reiterate our interest in not making adjustments in one area which might have the unintended consequence of disrupting another. But things did change.

The second week of May it was all about moving milk out of Sacramento rather than moving it in. Fears of not finding a home for summer milk nor a truck to haul it in grew as I began touching base with the industry. Discounts appeared, then doubled as companies learned of the true cost of handling the rising supply of milk. Crystal made the difficult decision to restrict purchases from its producers to contractual levels starting in June when schools closed for the summer and our producers were notified of this new policy.

In the following weeks, our dairy farmers wrestled with whether or not they could operate their dairies under Crystal's new policy. In the end, several came to the difficult conclusion that reductions were not possible and finding a new home for their milk was in their west interest. Surprising to us another buyer was willing to take their milk and by June 16th our excess supply problem was over. We suddenly had options for meeting our milk needs that had not been possible before and the future seemed filled with interesting possibilities.

The following week we received notice of a substantial rate increase from the company that hauls our producer's milk. Following an annual review, they increased the base haul rate by 6 cents per hundredweight effective July 1st, 2006. Because the hauler had failed to activate a fuel adjuster clause at the quarterly opportunities provided in the hauling agreement, August 1st of 2006 will bring an additional increase of 4 cents her hundredweight attributable to fuel price escalation in the past year. Their having overlooked this clause seems a likely explanation as to why our dairies experienced no haul rate increases in the past 12 months while other producers did.

The final developed pertinent to today's hearing was the announcement last Friday that the company is planning to close the downtown Sacramento facility and transition all processing operations across town to our Belvedere facility in southeastern Sacramento. This decision directly impacts yogurt, sour cream, ice cream and the ability to produce our own condensed skim for fortification. The target date for closure is August 31st, 2006. Also part of the same notice was the owner's tentative plans to bring these product lines back into production in Belvedere by the end of 2007 to 2008.

As you can see, we've been busy -- as you can see, we've had a busy two months and the rather dramatic change in the circumstance created an interest in milk movement incentives beyond that of transportation allowances, yet the timing of this hearing and the associated alternative proposal process left us in a quandary over our testimony. In the end, we felt it foolish to miss the opportunity of a hearing during which both the Department and the industry could be informed of our changing needs relative to milk movement incentives. Therefore, the remarks that follow will cover both adjustments to transportation allowances in our area and a request to expand transportation credits to include Sacramento County.

Let me start with transportation allowances. DFA the filed an alternative proposal which adjusts allowances in northern California. For milk moving into the Sacramento deficit area, DFA proposes a 1-cent per hundredweight increase for milk in the 0 through 59 miles bracket and a 2-cent per hundredweight increase for milk located over 59 miles from the market. Without the benefit of an updated ranch-to-plant hauling rate comparison, which is usually supplied by CDFA prior to a milk movement hearing, we're not in a position to know what changes have occurred in rates in the areas surrounding Sacramento. That leaves us unable to assess the relationships in terms of local to longer hauls or dairies located equidistant between deficit areas. But we do know transportation rates for our dairies will be up 6 cents per hundredweight July 1st and will increase another 4 cents per hundredweight August 1st. We also know that despite having excess milk three weeks ago, we do not have that problem today and absolutely need to continue to attract milk from the surrounding area into Sacramento for our ongoing operations.

In our January 31st, 2006, testimony, which is attached for your reference, we discussed reasons why local milk might not be available to us now and in the future. Our recent experience with several Crystal producers being able to move a sizable amount of milk to a new buyer despite an abundance of milk in the industry validates our belief that milk movement incentives in Sacramento are still required. We are supporters of cost-justified modifications to transportation allowances and urge the Department to consider our producer's new hauling rates along with those provided by DFA to determine the most appropriate adjustments to transportation allowances as a result of this hearing.

In addition, we ask that the Department -- we ask the Department to be mindful of the impact that any changes in transportation allowances might have on competing handlers in adjacent deficit areas and work to alleviate any disadvantages before the final announcements are determined -- final allowances are determined. I'm sorry.

This hearing involves both transportation allowances and transportation credits. Up to this point in time, Crystal has only relied upon the transportation allowance system to help attract milk to its plants. Sacramento County is not a designated deficit county as identified in Section 300.2 of the Stabilization and Marketing Plan for northern California marketing area.

With the changes that have occurred within Crystal over the past few years and those planned for the near future, we believe inclusion in the transportation credit system is now warranted. In 2002, we ceased manufacturing nonfat dry milk. Earlier this year we stopped producing butter. And by the end of the summer we will lose the use of our evaporator for making condensed skim. Solids for fluid fortification will have to come from manufacturing plants out of the area, and based on the reduced volume of milk from dairies under contract with Crystal, it is also likely we will require some supplemental milk to meet the fluctuating needs of our customers.

Since the early 1980s processors located in the Bay Area and in southern California have had procurement options that are assisted by either the transportation allowance system or the transportation credit system. We would like to have those same options. We consider plants located in Stanislaus or Merced counties to be the most likely source for plant-to-plant shipments but have been told plants in Fresno County or even Tulare County are options as well.

We're not certain what the freight costs might be for regularly scheduled deliveries, but have made some spot purchases in the past few months and several hauls in the reverse direction to dispose of excess milk that were $375 per load or 75 cents per hundredweight for a 50,000 pound load. We did compare this rate with Figure 10, "Relationship between Hauling Rates and Distance Between Plants" in the document entitled "Background Material Specific to Milk Movement Incentives" prepared by the Department and distributed at the June 13th, 2006, pre-hearing workshop.

Lacking constructive mileage, which would be greater than physical miles traveled MapQuest indicated it was 70 miles to the closest plant in Stanislaus County. Figure 10 would have the haul just under 60 cents per hundredweight in August of 2005. The furthest location within these two primary counties is 131 miles from Sacramento and figure 10 shows a haul rate of approximately 80 cents per hundredweight. Taking into account a spot load delivery cost versus a contracted rate in comparison to Figure 10's 11-month old data, we believe it would be appropriate to use 75 cents per hundredweight as a starting point. Our request of the Department is to expand transportation credits as a result of this hearing to include Sacramento County as a designated deficit county and Stanislaus and Merced counties as the designated supply counties with a maximum deduction (credit) of 75 cents per hundredweight.

Our final comment involves Western United Dairymen's alternative proposal to remove the shipment of condensed skim from the list of products eligible for transportation credits. Unless we learn something from their oral testimony the changes are opinion, Crystal opposes removal of condensed skim from the transportation credit system. We believe the greatest degree of equity is afforded to producers and handlers alike when reasonable choices are available to all parties and the inclusion of condensed skim assists in that process.

If California did not have minimum solids-not-fat standards above that of incoming milk, the fluid market could be satisfied by any source of bulk milk -- direct shipments from independent dairies, cooperative dairy ranch diversions or by plant-to-plant shipments. But that's not the case. Our fluid products must be fortified for sale within the State of California. Fortification with wet solids requires condensed skim. If I understand the transportation credit system correctly, tailored milk currently falls within the definition of milk and is therefore eligible for a transportation credit. Without the inclusion of condensed skim in the transportation credit system, it seems to us that economic advantage would lean toward the tailored milk supplier. The fluid processor who prefers to purchase condensed skim and fortify their own product could be at a competitive disadvantage. Additionally, the independent producer could find it difficult to remain attractive to fluid bottlers under these circumstances. We believe the Department made the correct decision in 2003 to include condensed skim in the transportation credit system and oppose its removal as a result of this hearing.

That concludes my written testimony. We appreciate having the opportunity to present our ideas and comments on the proposals. We hope the information we have provided is useful to the Department and look forward to the final determinations as a result of this hearing.

I would also like to request the opportunity to file a post-hearing brief.

HEARING OFFICER AYNES: Are there panel questions?

MILK POOLING BRANCH CHIEF LEE: I have a question.

Are some of your requests regarding transportation credits related to the changes of the needs of your plant? For instance, when your Belvedere plant comes back up on line with the additional products that you're closing down at the downtown plant, would your position on transportation credit change at that point?

MS. HALE: It's hard to say what the future holds.

MILK POOLING BRANCH CHIEF LEE: Yeah, that's --

MS. HALE: Yeah, right now that plant is -- for clarification, that plant is a fluid plant -- it's a fluid bottling plant. That is in fact where we do all of our fluid processing. And as the future unfolds, if we in fact are able to bring back those other products, how we would feel at that time, I don't know that -- I don't know that it would or would not change. It depends on, you know, what the available milk supply might be for us. Easily that could be an issue for us. And the timing of -- if you buy raw milk, you buy it seven days a week. And the other products, you can vary that.

MILK POOLING BRANCH CHIEF LEE: Thank you.

HEARING OFFICER AYNES: Are there further panel questions?

AGRICULTURE ECONOMIST GOSSARD: Yes.

In your testimony you mentioned a 6-cent per hundredweight and a following 4-cent per hundredweight increase in hauling costs for your dairies, for a total of 10 cents. But that 10 cents could affect both the local haul and the distant haul?

MS. HALE: Right.

AGRICULTURE ECONOMIST GOSSARD: So it's hard to say what the net effect would be on the -- as applicable to the allowance; it's --

MS. HALE: Right.

AGRICULTURE ECONOMIST GOSSARD: -- just that rates are going up is what you're trying to say?

MS. HALE: The rates are going up. And that's in fact why I did make the comment that -- normally we have the departmental exhibit that helps us ascertain whether or not the relationship actually changes from one area to the other. But certainly we would anticipate and expect the Department would look at those relationships before making a decision.

AGRICULTURE ECONOMIST GOSSARD: Also in your testimony you said the Department needs to be mindful when making adjustments to allowances in northern California of the effect upon handlers in different receiving areas. Now, you've proposed transportation credits for the

Sacramento area. How might that affect the competitive situation for processors in the North Bay, which have allowances but no credits?

MS. HALE: Well, certainly I had anticipated that someone from the processor in the North Bay would actually be here today, considering that individual had come to the pre-hearing workshop.

It may or may not have an impact. I can't say that. I don't know.

AGRICULTURE ECONOMIST GOSSARD: No further questions.

HEARING OFFICER AYNES: Any further panel questions?

Thank you for your testimony.

MS. HALE: Thank you.

HEARING OFFICER AYNES: And it would appear to be the last organization on the list. Swiss Dairy.

Do you wish to submit this document as an Exhibit?

MR. JAMES: Yes, I do.

HEARING OFFICER AYNES: Then your document will be admitted as Exhibit No. 53.

(Thereupon the above referenced document was marked by the Hearing Officer as Exhibit 53.)

HEARING OFFICER AYNES: Would you state your name and spell your last name.

MR. JAMES: I'm Steve James J-a-m-e-s.

HEARING OFFICER AYNES: Do you swear or affirm to tell the truth and nothing but the truth?

MR. JAMES: I do.

HEARING OFFICER AYNES: And are you representing an organization?

MR. JAMES: I represent Swiss Dairy.

HEARING OFFICER AYNES: And what type of organization is that? I assume it's one that doesn't have members particularly?

MR. JAMES: It's a processor. We are a processor. We are a subsidiary of Dean Foods.

And this testimony was written by me in collaboration with our Director of Dairy Policy in Dallas at headquarters.

HEARING OFFICER AYNES: Thank you. You may proceed.

MR. JAMES: Mr. Hearing Officer and members of the Hearing Panel. My name is Steve James. I'm President and General Manager of Swiss Dairy, a wholly owned subsidiary of Dean Foods Company. As General Manager, I'm responsible for every aspect of my company's operation, from raw milk procurement to customer service, from production and quality to distribution. From this vantage point I have the opportunity to see all aspects of the competitive landscape that are pertinent to this hearing.

I want to begin by thanking CDFA for recognizing the impact of the decision from the January hearing on this same topic and convening a hearing promptly.

Today I will share from Swiss Dairy's perspective some of the reasons we feel changes are needed. I'm here to support testimony of Dairy Institute of California and to support the request of CDI with respect to proposed changes in the transportation credit rates on plant-to-plant shipments from L.A. County (Artesia) to Riverside County.

History of the Swiss Dairy Milk Supply:

As many likely know, Swiss Dairy had a long history with another milk supplier providing milk from the South Valley. This supplier had a record of unsuccessful efforts to support changes in the transportation credits to help with the costs associated with supplying Swiss. Knowing the competitive challenges we face, we had to reevaluate our milk supply situation. Transportation credits were a part of that analysis. They were particularly important in considering the exact source of our supply.

We therefore arranged a program with CDI. In order to adequately serve our needs CDI had to choose between investing in Tipton or Artesia. The transportation allowance and credit rates in place at that time created an incentive to make the investments in Artesia. Creating incentives and then taking them away is destructive to the industry and the competitiveness of California-based plants. When companies make investments on the basis of such incentives, rapid policy changes can have the impact of stranding assets in what ultimately become undesirable locations, resulting in economic waste.

The ability to have competitive raw product costs is important to us. The transportation credit system must adequately compensate the milk supplier so that milk can be attracted to Class 1 use at order prices. When credit rates are not adequate, suppliers have a reduced incentive to supply the Class 1 market unless the processor pays additional premium monies to draw the milk. These premium dollars, however, make us less competitive in the marketplace.

Impact of the January Hearing on the Credit Change:

I've never been too concerned from a competition standpoint about transportation issues in California as they related to the credit program. I've always viewed them as being competition neutral. I feel that CDFA has always done a good job dealing with the issue of pooled dollars to attract milk for Class 1 use in a manner that was most efficient.

The latest transportation hearing decision is the only time in the eight years I've been here the changes have singled me out and put me at a competitive disadvantage, not only among other southern California processors, but at a further disadvantage with respect to out-of-state competition as well.

I know that I'm going to say the obvious here. But if you review the results of the January hearing, virtually all other milk supplies were made more competitive. Specifically, ranch-to-plant allowance rates into southern California were increased and credits from the South Valley were also increased. Swiss was the only entity to have its competition -- its competitive position worsened as a result of the last hearing. Surprisingly, there was no proposal for such a change and little testimony to that effect. This is very troubling for us from a philosophical standpoint. It seems to suggest that if we want to continue the status quo, we must come and testify in support of it, even when there's no specific proposal for a change.

Even more disturbing is the fact that the change was the opposite direction of all the other changes that were made.

Competitive reality:

For Swiss Dairy and ultimately Dean Foods to survive and prosper it must purchase raw milk at competitive prices. While there have been recent changes in the regulations impacting out-of-state neighbors, those anticipated impacts have yet to be seen in the marketplace. Thus being competitive includes recognizing the availability of alternative milk supplies including those located out of state.

Let me be clear. I do not want to turn this issue into one of competitiveness of the overall level of Class 1 California milk prices. However, I do want to point out that if the California pool is unable to incentivize ample milk for my plant, we are not in a position to pay premiums and pass them on in this competitive market.

If premiums are our only option for a milk supply, we will have some difficult decisions to make regarding where we will source producer milk.

We prefer to buy California milk. But buying competitively takes precedence. At the risk of sounding like a broken record, our preference is to buy California milk and bottle it at our California plants for our California customers. We understand the implications of unregulated out-of-state milk brought into California. We know the such milk takes dollars that could be returned to California dairymen and pays them instead to truck drivers and oil companies and to out-of-state dairy farmers. While we have a philosophical preference to support California, the philosophy is not to do it at the expense of our customers' business and shareholders.

Summary:

Again, I want to thank the Department for quickly convening this hearing to address a very real impact to a prior decision. I would simply request that based on the above real-life illustrations, the Department keeps Swiss Dairy competitive by adopting transportation allowance and credit rates that are in accordance with the current costs of moving milk. We urge you to adopt CDI's proposal.

Thank you for allowing me to express the views of Swiss Dairy and Dean Foods.

I'd like to respectfully request the opportunity to submit a post-hearing brief. And I'd be happy to answer any questions.

HEARING OFFICER AYNES: Are there Panel questions?

AGRICULTURE ECONOMIST GOSSARD: As I understand your testimony, you want to be placed -- put in the position where the cost of receiving your milk supply is comparable to the cost of other plants, using safe transportation allowances; is that correct?

MR. JAMES: That would be correct.

AGRICULTURE ECONOMIST GOSSARD: On the other hand some departmental analysis indicates that the cost to the pool of servicing plants in southern California using credits or a combination of allowances and credits is higher than using allowances alone. That's a little disturbing for the producers segment, as they would like to subsidize the -- well, probably not -- but in reality they are required to subsidize the movement of milk to Class 1 plants and to the pooling system. But the Department has the need to do that in an efficient manner, is supply, pay -- having the pool spend more money for comparable volumes of milk, supplying your plant an efficient way to distribute those monies.

MR. JAMES: Well, I'm not an economist and I haven't been privy to the Department's calculations. But the point I'm trying to make is that if you want to have that kind of economic analysis and reevaluation of the whole system, then it should be done separately. And when you take a transportation credit and allowance hearing and adjust the credits for only -- that affect only one plant, then you are taking a philosophical economic decision that is having impact on a competitive marketplace where customers change suppliers, change processors on the basis of mils and quarters of a cent. So I just think that that kind of economic analysis needs to be done openly, collaboratively. And I support cost-based decisions that support the most economic and most efficient movement of milk at no additional cost to the pool.

AGRICULTURE ECONOMIST GOSSARD: Thank you. No further questions.

HEARING OFFICER AYNES: Any further Panel questions?

Thank you for your testimony.

MR. JAMES: Thank you.

HEARING OFFICER AYNES: Is there anyone else who wishes to testify?

Seeing none.

There will be a post-hearing briefing period. The request for a post-hearing briefing period by the witnesses is granted. The witnesses shall be provided the opportunity to submit a brief amplifying, explaining or withdrawing their testimony.

In order for the brief to be considered, the Department must receive the brief by 4 p.m., Friday, July 14th, 2006. The brief may be sent or delivered to the Department's Dairy Marketing Branch located at 560 J Street, Suite 150, Sacramento, California 95814.

The brief may also be fax'd to the branch at Area Code 916, the number 341-6697, or sent by e-mail to Dairy at CDFA dot CA dot GOV.

Having received no additional requests for testimony, this hearing is closed.

The Department will respond to the petitions as required by applicable statutes and regulations.

We're closed.

(Thereupon the Department of Food and Agriculture Market Milk Hearing adjourned at 11:40 a.m.)

CERTIFICATE OF REPORTER

I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, and Registered Professional Reporter, do hereby certify:

That I am a disinterested person herein; that the foregoing Department of Food and Agriculture, Dairy Marketing Branch hearing was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California, and thereafter transcribed into typewriting.

I further certify that I am not of counsel or attorney for any of the parties to said hearing nor in any way interested in the outcome of said hearing.

IN WITNESS WHEREOF, I have hereunto set my hand this 17th day of July, 2006.

JAMES F. PETERS, CSR, RPR
Certified Shorthand Reporter
License No. 10063